

No. 12054

United States
Court of Appeals
for the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY,
a corporation,

Appellant,

VS.

WESTVACO CHLORINE PRODUCTS COR-
PORATION, a corporation,

Appellee.

Transcript of Record

(In Three Volumes)

VOLUME III.

(Pages 901 to 1329, inclusive)

Appeal from the United States District Court
for the Northern District of California,
Southern Division

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(Testimony of David Watt.)

Q. Will you state what depreciation is charged to gypsum, that is, depreciation on what portion of the entire plant?

A. Depreciation on the gypsum plant only.

Q. What do you describe as the gypsum plant?

A. The portion of the main plant where the gypsum is manufactured.

Q. Does that mean the filter, the drier—

A. The filter, the drier and the loading equipment.

Q. And the what?

A. And the loading equipment.

Q. And the grinding?

A. And the grinding and the warehousing.

Q. That is devoted to gypsum?

A. Gypsum only, yes.

Q. In your opinion, is the straight-line method a proper method for computing that depreciation?

A. For a chemical plant such as ours, I do not know what other kind of method you would use. After all, in a chemical plant where you have salt of any kind, the corrosion is so high, I do not know how else you could use depreciation other than on a straight-line method.

Q. Would there be any variance in the corrosion or wearing of equipment according to the quantity of product produced in it?

A. Oh, no, not at all.

Q. So that you feel that the straight-line depreciation is the [865] proper basis upon which to compute the depreciation of the plant? A. I do.

(Testimony of David Watt.)

Q. (By the Court): Familiarize me with the straight-line method again.

A. That is a composite method overall. Instead of taking various depreciation rates for individual pieces of equipment, you use the composite rate over the whole plant.

Q. (By Mr. Rosenberg): Is straight-line depreciation based upon the estimated life of the property? A. Yes.

Q. And you depreciate the property on a straight-line basis or, in other words, at so much per year spread over the expected life of the property?

A. For a given period of years, yes.

Q. With reference to taxes, will you state on what property taxes are charged to gypsum?

The Court: Real property?

Mr. Rosenberg: That is what I am asking, your Honor.

Q. In other words, in these various accounts under the cost of production of gypsum, there appears an item for taxes. What does that include?

A. That includes property taxes.

Q. On what?

A. On the whole of the plant, and then the whole taxes, the [866] tax cost is split on the plant value and allocated to the various departments on the value of the equipment in these departments.

Mr. Rosenberg: I hope you won't object to this, Mr. Bennett. I am going to ask a leading question.

(Testimony of David Watt.)

Q. Is this true, that for the purpose of allocating taxes to gypsum you charged to gypsum such proportion of the taxes on the entire plant as the value of the gypsum plant bears to the entire plant?

A. That is correct.

Q. Can you state whether or not substantially the same method is employed in allocating insurance?

A. The same method.

Q. Now, there has been mentioned throughout the testimony repair labor. Will you explain what that is? What type of labor falls within that category?

Mr. Bennett: If it may save time, we are not questioning that repair labor that is directed to any part of this plant or machinery devoted to the gypsum is not a proper charge. We have taken the position all along that it is, Your Honor. I say that there is no question about that. If repair labor of the category of overhead, that is, not on a direct basis, has to be allocated on some reference basis, then, of course, we would object to that because it injects the element of conjecture and uncertainty where the contract requires, [867] according to our understanding of the language used, the actual increase of the cost of manufacture, which is not consistent with anything involving uncertainties or speculation.

Q. (By Mr. Rosenberg): There has also been mentioned supervision labor. Will you explain what category of labor falls under that head?

A. Plant supervisors.

(Testimony of David Watt.)

Q. What are the functions of the plant supervisors?

A. Well, they are what you call shift supervisors and they are in charge of the whole of the plant during their various shifts.

Q. When you speak of the whole plant, does that include the gypsum plant?

A. Oh, definitely.

Q. When you say they are in charge of it, what are their duties?

A. Well, the supervisors at the Newark plant are all chemical engineers and they have to supervise all processes.

Q. And that would include the gypsum processes? A. Definitely.

Q. Is there any other type of labor that falls within that category? A. No.

Q. That is all. With reference to indirect shipping expenses, will you describe to the Court what they consist of?

A. Indirect shipping expense consists of shipping department [868] supervisor, his assistant, shipping clerks, and any other miscellaneous charge that cannot be directly allocated to any given product.

Q. Such as what?

A. Janitor sweeping up the warehouse, anything miscellaneous of that description.

Q. Will you describe your shipping department over there and tell us what products are handled out of that department? The labor that is contained

(Testimony of David Watt.)

in your statements under the description of shipping labor, who are the parties who perform those services? A. Is that direct or indirect?

Q. Direct.

A. That is the shipping—the men in the shipping department who handle the various products of loading in into cars, bagging it, or whatever the case may be.

Q. And the ones whom you include under indirect you state are foremen, assistant foremen?

A. That is correct.

Q. Would that include a shipping clerk?

A. Yes.

Q. Tractor operator? A. No.

Q. Not that? A. Not that. [869]

Q. To the shipment of what products do those employees devote their time and efforts?

A. All products going out of the plant.

Q. Would that include gypsum?

A. Definitely.

Q. Would it be practical or possible for those employees to keep records of their time, indicating the amount of time that they spent on shipping each of the various products that they handle?

A. It would be impossible.

Mr. Bennett: Now we are talking about the so-called indirect.

The Court: Shipping expense.

Mr. Bennett: Indirect. There are two classes, I understand: one of direct, which there is no dispute about, and this is indirect.

(Testimony of David Watt.)

Q. (By Mr. Rosenberg): There has been some discussion of the charges for work in the laboratories at Newark. Will you describe the laboratories, that is, just what laboratories or laboratory accounts enter into your cost accountants at Newark?

A. Well, we have only the one laboratory, that is, the control lab.

Q. How is the time in the control laboratory or the expense charged to the various products that are handled in there?

A. Each chemist keeps a daily time card on which he allocates [870] his time to the various products that he analyzes.

Q. How is that charged? Directly to the product?

A. Directly to the product.

Q. Are there any indirect laboratory charges?

A. Yes.

Q. What do they comprise?

A. Your chief chemist, your assistant chief chemist, I believe one stenographer, janitor, miscellaneous supplies that are used overall that cannot be allocated to given products.

Q. How are those charges distributed?

A. They are allocated to all products.

Q. Including gypsum?

A. Including gypsum.

Q. On what basis?

A. On the basis of the direct charges to the various products.

(Testimony of David Watt.)

Q. When you are talking of the direct charges, do you mean the direct charges in the laboratory?

A. Yes.

Q. In other words, those are not distributed on the same basis as your general overhead?

A. Oh, no.

Q. Getting into general overhead, those are distributed on what basis?

A. On a direct labor basis.

Q. There has been some mention of a research laboratory. What [871] is that?

A. The research lab?

Q. Yes.

The Court: This same laboratory?

A. No, a different laboratory altogether.

Q. You said there was only one laboratory?

A. Well, there is only one control laboratory.

The Court: That is all right.

Mr. Bennett: I think Your Honor's question is very pointed.

The Court: I only wanted to follow his testimony.

Q. (By Mr. Rosenberg): In other words, there is another laboratory, is there?

A. Oh, yes, sure.

Q. And that is what?

A. The research laboratory.

Q. What services are performed in that laboratory?

A. Well, I would say testing, improving, working out new analyses, trying to find new products.

(Testimony of David Watt.)

Q. New products to derive from bittern?

A. To derive from bittern, yes.

Q. How are those charges in that laboratory distributed?

A. On the same basis: directly to the products where it can be distributed.

Q. And the supervisor or general or miscellaneous are [872] distributed on what basis?

A. Allocated on the direct basis.

Q. By direct basis what do you mean?

A. I mean those charges already charged to the various products by the research chemist.

Q. In other words, the general or indirect charges in the research laboratory are charged with the various products in the plant in the proportion that the direct labor performed in the laboratory on the various products bear to the entire expense of the laboratory?

A. That is correct.

Q. I think I neglected to ask you how the indirect shipping expenses are allocated among the various products.

A. Allocated on a tonnage basis.

The Court: Develop that.

Mr. Rosenberg: What is that?

The Court: Just to say they are allocated on a tonnage basis, you had better develop that situation.

Q. (By Mr. Rosenberg): Yes. Will you explain what you mean by that, Mr. Watt?

(Testimony of David Watt.)

A. Well, each month we sell so many tons of all the products that we produce, and we have a certain amount of indirect shipping expense; so the indirect shipping expense is spread over the tonnages that we sell each month.

Q. In other words, they are charged to the various products in [873] the proportions that the tonnages of each product handled bears to the whole?

A. Yes, that has been shipped out of the plant.

Q. Has that always been the method of allocation employed at the plant?

A. No, it has not.

Q. When was there a change in that method?

A. The change was made about the middle of 1945.

Q. Prior to that time what had been the basis of allocation?

A. The dollar value of the products sold each month.

Q. In other words, the indirect expenses were spread between the various products according to the dollar value of each product related to the whole?

A. Yes, that is correct.

Q. What was the reason for making that change?

A. The reason for making the change was that in my estimation dollar value had nothing to do with shipping. The only way that I could see that shipping expense should be allocated was on tonnage handled by the shipping department.

(Testimony of David Watt.)

Q. Could you state approximately how the quantity of gypsum produced in the plant compares to the quantity of magnesia?

The Court: Tonnage?

Mr. Rosenberg: Tonnage.

The Witness: Roughly, 50 per cent.

Q. (By Mr. Rosenberg): About 50 per cent?

A. 50 per cent.

Q. You mean of the whole?

A. Of the whole, yes.

Q. In other words, the amounts of each are approximately the same? A. Yes.

Q. In distributing these various costs at the Newark plant, can you state whether or not you employed the same methods or principles with relation to each product there? A. Absolutely.

Q. In other words, you do not have one method for gypsum and some other method for some other product? A. No.

Q. Your accounting methods are uniform as to all products, is that right?

A. For all products, yes.

Q. Now, you stated that general overhead is allocated among the various products at the plant on what basis? A. Direct labor.

Q. Will you explain what you mean by that, Mr. Watt? Just explain your procedure. Elaborate on it a little. [875]

A. Each product made has a certain amount of operating and repair labor, so general overhead is allocated to each product on the sum of the oper-

(Testimony of David Watt.)

ating and repair labor as it bears to the whole of the operating and repair labor throughout the plant.

Q. Has there been any change in accounting practice in that respect at any time?

A. Yes, we did change. January, 1946, I believe it was that we changed.

Q. What change occurred at that time?

A. In January, 1946, we went to direct labor as the basis, which is the operating and repair labor. Prior to that we spread overhead on the combined supervision and operating labor only.

Q. Mr. Watt, I will show you the defendant's answer to interrogatory 10-E. Did you provide the information that is contained in that answer?

A. I did.

Q. Will you just relate the changes in accounting practices that have taken place during the time that this contract has been in effect?

Mr. Bennett: To save time, if nothing else, Counsel, are you just going to have the witness read the changes that have been stated in your answers?

Mr. Rosenberg: No, I am asking him to explain. [876]

Mr. Bennett: Why they were made?

Mr. Rosenberg: Yes.

Mr. Bennett: That is different.

Q. (By Mr. Rosenberg): First, Mr. Watt, will you tell us what changes, if any, have been made in the method of allocating general overhead?

Mr. Bennett: Isn't that covered by your answer to the interrogatories?

(Testimony of David Watt.)

Mr. Rosenberg: I would like him to refresh his memory, because I am not sure his answer was correct, Mr. Bennett.

Mr. Bennett: What answer?

Mr. Rosenberg: The one he just gave.

Mr. Bennett: In what particular?

Q. (By Mr. Rosenberg): Will you read the answer that was given?

A. "Prior to January 1st——"

Mr. Rosenberg: No, I mean I would like to have the reporter read the last answer of the witness.

(Record read.)

Q. (By Mr. Rosenberg): What was the reason for making that change in spreading overhead?

A. It was a refinement in accounting, as far as we were concerned.

Q. Was that change made uniformly throughout the plant or was it only made as to gypsum?

A. Throughout the plant.

Q. During what period of time had you been allocating overhead [877] on the basis of supervision and operating labor?

A. January 1, 1944, to January 1, 1946.

Q. At all times prior to that and subsequent to that period you have used what as the basis for allocating?

A. Direct labor, operating and repair combined.

Q. Mr. Watt, have you prepared a tabulation showing what the cost of producing gypsum would have been in accordance with the books and rec-

(Testimony of David Watt.)

ords of Westvaco Chlorine Products Corporation for the period from July 1, 1945, to June 30, 1946, employing the same accounting methods in that period as were employed in the prior period, or are you having such a statement prepared?

A. I am having such a statement prepared.

Q. When do you expect to have that?

A. I hope I will have it Friday morning. I do not know if the office is working today.

The Court: I think this is a good place to pause and adjourn for the Christmas season, gentlemen. I want to wish all of you the blessings of the season, and I hope at this time next year we will have the hope and peace in years to come, of which this year was not very productive.

Mr. Rosenberg: I am sure we all feel the same about that.

Q. (By the Court): You will have your data Friday morning?

A. I hope so, your Honor. [878]

The Court: This is not an oration, gentlemen. I would like you to think about it. I think the crux of this case is with this witness on the stand. I propose to give you all the time you want. At times I get a little impatient. That is not with the thought of doing anyone an injustice.

(Discussion between court and counsel.)

The Court: With that we will adjourn until Friday morning at ten o'clock.

Mr. Rosenberg: Thank you, your Honor. I am sure we all wish you a very Merry Christmas and

(Testimony of David Watt.)

hope we will have the privilege of exchanging those greetings for many years to come.

Mr. Bennett: Yes, your Honor.

The Court: I hope when we get through here I won't disappoint anyone.

(Thereupon an adjournment was taken until Friday, Dec. 26, 1947, at 10:00 o'clock a.m.)

Friday, December 26, 1947, 10:00 o'clock a.m.

The Clerk: Pacific Portland Cement Company vs. Westvaco Chlorine Products Company.

Mr. Rosenberg: Ready.

Mr. Bennett: Ready.

DAVID WATT,

recalled as a witness on behalf of defendant; previously sworn

Direct Examination (resumed)

Q. (Mr. Rosenberg): Mr. Watt, have you some figures with you showing the amount of gypsum produced and the amount of magnesia produced and the quantities of sales of those two products during certain years that this contract has been in effect?

A. I do.

Q. Do you have them with you?

A. They are in my briefcase.

Q. What years does that information cover, Mr. Watt?

A. It covers from the year 1937 up to June 30, 1946.

(Testimony of David Watt.)

Q. Will you state the quantities of gypsum and magnesia produced during those periods and the quantities of magnesia produced and sold during that period of time?

Mr. Bennett: The witness is referring to some document before the question is asked, and I am precluding from making [880] an objection. May I look at this document?

Mr. Rosenberg: Yes.

Q. From what source was that information taken, Mr. Watt?

A. From the books of the company.

Q. At the Newark plant?

A. At the Newark plant, yes, sir.

Mr. Bennett: I don't know, your Honor, the precise purpose counsel has in this, but it presents again a somewhat difficult practical problem that is presented to us. I have indicated heretofore that we do not wish to interpose objections, particularly any that are technical in nature which will have the effect of unduly prolonging the case, or making difficult or tedious its presentation. At the same time we feel that we should not waive the best evidence rule to the extent that we are bound by figures that may be presented by witnesses here where we do not have the opportunity adequately to test them.

Perhaps I have not made my point clear. If I knew more definitely the purpose of this evidence, it might aid us in waiving the objection or making it. I told your Honor at the start that we would

(Testimony of David Watt.)

try to present this case and conduct the trial of it so far as we were concerned on our side, to present to your Honor the basic principles of law and fact, trusting that if it became necessary to get down to actual figures—— [881]

The Court: Indicate the purpose of this testimony.

Mr. Rosenberg: Yes, your Honor. There has been mention throughout the trial of the relative quantities of magnesium and gypsum produced. I asked Mr. Watt to take from the records of the company the quantities of the two products produced. Now, it may be that this is not the best evidence. However, they are figures that the witness states under oath were taken directly from the books of the plant, and as the court can appreciate, and Mr. Bennett also, it would just be a practicable impossibility for us to bring all of the records into court here because we just could not continue to operate over there.

Is there any question about the fact that these figures have been honestly taken from the records, Mr. Bennett?

Mr. Bennett: Mr. Rosenberg, I always hate to be in a position of questioning one's honesty.

The Court: It may come in subject to correction.

Mr. Bennett: That perhaps would be the most expeditious way of doing this.

The Court: If there are any corrections to be noted, that may be done later.

(Testimony of David Watt.)

Mr. Bennett: We have noted, as your Honor knows, corrections that have been made by the defendant, himself, on original figures, on claims, for example, and I presume they are errors, and if your Honor will admit this subject to our right to verify or correct it, then I will not make objection. [882] This witness, as well as preceding witnesses produced by you, refer to the magnesia, itself. Now, there have been numerous other products produced. Is it your contention under the title "Magnesia" that that involves all of the other products produced in this process during the years in question?

Q. (Mr. Rosenberg): Does it, Mr. Watt?

A. Pardon me?

Q. On magnesia produced, does that include all magnesia products produced? A. Yes.

Mr. Bennett: And no other products?

Q. (Mr. Rosenberg): Are there any other magnesia products that are not contained in this tabulation?

A. These are all magnesia products.

Mr. Bennett: The evidence also shows that until very recently you produced bromine from the very beginning, and nothing is shown from these figures as to the quantity of bromine produced.

Q. (The Court): Do you know that?

The Witness: I don't know exactly year to year, but we can get those figures if necessary.

The Court: You may proceed, counsel.

Mr. Rosenberg: Do you want the bromine figures?

(Testimony of David Watt.)

Mr. Bennett: Well, bromine and lime. I understand you produced and sold a lot of lime down there.

The Court: As I follow this testimony and the purpose of [883] it, you want to prove the amount of magnesia and gypsum produced?

Mr. Rosenberg: That's right, your Honor.

The Court: Does that have any relation to this bromine production?

Mr. Rosenberg: That is up to Mr. Bennett. If I understood plaintiff's position, their position is that the gypsum is produced incidental to the magnesia. I have not heard any mention of bromine, but we have not any objection at all to providing those figures.

Mr. Bennett: You may offer those figures for some purpose of showing relative productions at your plant, and I thought if that was the purpose that we should have all of them.

The Court: We have been discussing products and by-products and what-not, and also there is testimony already in the record in relation to the amount of magnesium produced and the amount of gypsum produced. Now, they went to the books, and I think without stretching the testimony out it is well for us to have the amounts.

Q. (Mr. Rosenberg): Will you state by periods the amount of magnesia produced in tons, the amount of gypsum produced in tons; and for the same period the amount of magnesia sold and the amount of gypsum sold?

(Testimony of David Watt.)

A. In the year 1937, magnesia produced—212 tons, gypsum produced—376 tons. Magnesia sold—54, gypsum sold—195 tons. [884]

In the year 1938, magnesia produced—7017 tons, gypsum produced—10,948 tons. Magnesia sold—5143; gypsum sold—9301.

The period July 1, 1939, to June 30, 1940, magnesia produced—19,085; gypsum produced—27,685. Magnesia sold—15,586; gypsum sold 26,776.

Period July 1, 1940, to June 30, 1941, magnesia produced—23,882; gypsum produced—32,000 even. Magnesia sold—13,831; gypsum sold 31,164.

The year 1942, magnesia produced—34,077; gypsum produced 31,826. Magnesia sold—26,929; gypsum sold—30,818.

The year 1943, magnesia produced—37,671; gypsum produced 24,431. Magnesia sold—28,727; gypsum sold—23,848.

Period July 1, 1944, to June 30, 1945, magnesia produced—41,004, gypsum produced—33,420. Magnesia sold—39,305; gypsum sold—32,582.

Period July 1, 1945, to June 30, 1946, magnesia produced—42,694; gypsum produced 36,658. Magnesia sold—40,032; gypsum sold—34,930.

Mr. Bennett: Counsel, are you offering that document in evidence?

Mr. Rosenberg: No, I am not.

Mr. Bennett: I wonder if it would not be at least convenient to both court and counsel if it would be marked for identification. We may want to refer to those figures, counsel, [885] and it may

(Testimony of David Watt.)

be more convenient to refer to them by the document than to go back through the reporter's transcript.

Mr. Rosenberg: I will say, Mr. Bennett, I can have copies made so you can have a copy and I can have a copy as well.

Mr. Bennett: Is there any objection to offering that for identification?

Mr. Rosenberg: No, but I want to take the document out so as to be able to make copies.

Mr. Bennett: Yes.

(The document was marked Defendant's Exhibit J For Identification.)

Mr. Rosenberg: Well, rather than have it marked for identification I will offer it in evidence.

The Court: It may be admitted in evidence.

(Defendant's Exhibit J For Identification was thereupon admitted in evidence.)

DEFENDANT'S EXHIBIT J

	July 1, 1945	July 1, 1944	Year	Year
	June 30, 1946	June 30, 1945	1943	1942
Magnesia Produced	tons 42,694	41,004	37,671	34,077
Gypsum Produced	tons 36,658	33,420	24,431	31,826
Magnesia Sold	tons 40,032	39,305	28,727	26,929
Gypsum Sold	tons 34,930	32,582	23,848	30,818
	July 1, 1940	July 1, 1939	Year	Year
	June 30, 1941	June 30, 1938	1938	1937
Magnesia Produced	tons 23,882	19,085	7,017	212
Gypsum Produced	tons 32,000	27,685	10,943	376
Magnesia Sold	tons 13,831	15,586	5,143	54
Gypsum Sold	tons 31,164	26,776	9,301	195

(Testimony of David Watt.)

Mr. Bennett: That is an admission in evidence subject to the same reservation that I have offered before, your Honor?

The Court: Yes, subject to any correction.

Q. (Mr. Rosenberg): Mr. Watt, there has been some testimony about an occasion in October, 1946, when Mr. Bannard, of Pacific Portland Cement Company, came to the Newark plant to inspect the record pertaining to the notice of increase that had been given by Westvaco to Pacific at that time. Do you recall that? [S86]

A. I do.

Q. Did you have discussions with Mr. Bannard at that time?

A. I did.

Q. What occurred on that occasion with reference to inspection of records or figures? How long did Mr. Bannard spend at the plant on that occasion?

A. I would say about three days.

The Court: Fix the time.

Q. (Mr. Rosenberg): When was that, Mr. Watt?

A. I believe it was September, 1946—September or October, 1946.

Q. What did Mr. Bannard do during those three days?

Mr. Bennett: Was this witness present?

Q. (Mr. Rosenberg): Were you present with Mr. Bannard at that time?

A. All the time.

Q. What did Mr. Bannard do on that occasion?

A. Made a general audit for all the charges for the two periods under review.

(Testimony of David Watt.)

Q. Those were what periods?

A. July 1, 1944, to June 30, 1945, and June 1, 1945, to June 30, 1946.

Q. Did you have any conversation with Mr. Bannard relating to the subject of overhead charge to gypsum?

A. Well, I did, yes. [887]

Q. Did Mr. Bannard raise any question as to the propriety of including general overhead?

A. No, he didn't.

Mr. Bennett: Now, Counsel, I have been talking to my client here and after this question was asked perhaps I should have made an objection to the question, although it may go to the weight rather than admissibility. The evidence so far shows Mr. Bannard was not authorized to negotiate with the defendant, that all his function included was to go down there and get the facts and figures.

The Court: For whom?

Mr. Bennett: What was that?

The Court: For whom?

Mr. Bennett: For Pacific.

The Court: Then they are bound by that.

Mr. Bennett: Mr. Bannard's function was not to permit Pacific——

The Court: No, but to get such information as they wished.

Mr. Bennett: That's right, but the point of whether or not he raised objection to overhead items——

The Court: Was anything said in relation to overhead?

(Testimony of David Watt.)

The Witness: He did check the overhead.

The Court: All right, he checked the overhead. Develop the facts whatever they may be.

Mr. Bennett: What I wanted to object to was the question [888] as to whether or not Mr. Bannard raised any objection to including overhead, as incompetent, irrelevant, and immaterial.

Mr. Rosenberg: I don't know—Mr. Flick said he was a certified public accountant and sent him down to use his own good judgment.

Mr. Bennett: I think Mr. Flick's statement was that he should use his own judgment as to how far he should go to get the facts.

Q. (Mr. Rosenberg): Now, Mr. Watt, I will refer your attention to Plaintiff's Exhibit 17, which is Exhibit E, to defendant's answer to the interrogatories, and direct your attention to the item of water, for which there appears to be no charge in 1942, and a charge of 1 cent per ton in 1943. Can you explain why it is that there was no charge for water in 1942?

A. Without going back to the actual statement for these two years, I would say that the charge for water for 1942 was so small that it made no difference in the unit cost. In other words, there was not any unit cost reflected, because the tonnage was so high and the water charge was so small—that is, in actual dollars.

Q. Can you state, Mr. Watt, from the fact that no charge appears in 1942 and a charge of 1 cent

(Testimony of David Watt.)

appears in 1943, would that result from any change in accounting methods or practice?

A. No, it did not.

Mr. Bennett: Are we talking now about inter-departmental [889] water or direct water?

Mr. Rosenberg: Direct.

Q. Referring your attention to Plaintiff's Exhibit 15, which is Exhibit F to the answers to the interrogatories under the account Fuel Oil, there appears to be a charge of 1 cent per ton in cost measured for the period from July 1, 1945, to June 30, 1946. and no charge for the same item in the preceding 12-month period. Can you explain how that occurred?

A. Again, without going back to the actual statements for this, I would say during the period July 1, 1945, to June 30, 1946, that at sometime during that period the gas was cut off and we had to go onto fuel oil.

Q. Do you know that to be a fact?

A. I don't know it to be a fact, but I would say that is what it is. I would have to check the records to find out if that is so.

Mr. Bennett: Rather than take up the time of the court, here, and require me to make a motion to strike that, had we not better defer detail matter of this kind on which the witness has no knowledge?

Mr. Rosenberg: I thought he had checked it, Mr. Bennett.

Mr. Bennett: I move to strike the answer.

(Testimony of David Watt.)

Mr. Rosenberg: Very well. I thought he had checked it, Mr. Bennett. That was probably my fault.

Mr. Bennett: In that connection we have not questioned or [890] objected as to the actual figures involved, either for this item of direct water, and without any waiver of right to object in future years——

The Court: Or the oil?

Mr. Bennett: Yes, or the oil, so far as these past periods are concerned. We thought that was made clear by our testimony.

Q. (Mr. Rosenberg): Referring your attention again to Exhibit 15 and the item Sulphuric acid, which appears as 35 cents for the period June 1, 1945, to June 30, 1946, and no charge for the preceding 12-month period—(Addressing Mr. Bennett): It has been stated in the record that item has been reduced from 35 cents to 23 cents, is that right, Mr. Bennett?

Mr. Bennett: Yes, since the original demand for price increase, and after the filing of our interrogatories you reduced the claim charge of sulphuric acid from 35 cents to 23 cents.

Q. (Mr. Rosenberg): Can you explain the reason for that reduction in that item from 35 to 23 cents?

A. We found we made an accounting error.

Q. And what was the nature of the accounting error?

A. That during the time the bromine towers were working, one of the accountants had missed

(Testimony of David Watt.)

up on an item and charged sulphuric to gypsum instead of towers.

Q. What has been the practice over the years in the plant with reference to the charge for sulphuric?

A. When the bromine towers were working, the sulphuric is [891] always charged to the bromine department.

Q. And during the time the bromine towers were working, was any charge for sulphuric made to gypsum? A. No.

Q. Has that practice been constant throughout the years? A. It has.

Q. What occurred to cause the sulphuric acid to be changed to gypsum?

A. In September of 1945—August or September, 1945, the towers closed down. The bromine towers closed down.

Q. You mean by that, that they discontinued the production of bromine over at the plant?

A. That's correct.

Q. Was there any production of bromine from the time that the bromine towers were closed down in September, of 1945, until June 30, of 1946?

A. There was.

Q. There was bromine produced? A. Yes.

Q. When?

A. Sometime in the beginning of 1946. That is why we discovered the 12-cent error.

Q. During what period of time—

The Court: Just a moment.

(Testimony of David Watt.)

Mr. Rosenberg: Yes. [892]

Q. (The Court): Explain that further, if you will.

A. (The Witness): When the bromine towers discontinued in September of 1945, before that we were charging sulphuric to the bromine. After they closed down we were charging sulphuric to gypsum. In the early months of 1946 the bromine towers operated, but one of the accountants kept on charging the sulphuric to gypsum. When we found that out we went back and corrected it and charged the sulphuric to the towers when they were operating, which resulted in a reduction of 12 cents of sulphuric to gypsum.

The Court: I understand. Very well, proceed, counsel.

Q. (Mr. Rosenberg): At any time during the operation of the plant at Newark has any of the sulphuric acid been charged to magnesia?

A. Never.

Q. With reference to the charges for depreciation, insurance, and taxes, has there been any change over the years in the methods employed in charging those charges to the various products produced? A. No, sir.

Q. With reference to the bittern, what has been the method followed at the plant in accounting for the bittern that is in the bromine, gypsum and magnesia produced?

A. It was allocated to the three products on an arbitrary basis. [893]

(Testimony of David Watt.)

Q. Will you explain what you mean by an arbitrary basis?

A. Well, the best basis that we could think of.

Q. As a matter of judgment?

A. As a matter of judgment, yes.

Q. Has there been any change in the basic method of charging the bittern to those products throughout the years over there? A. No.

Q. I believe when Mr. Flick was on the stand he mentioned the fact that you have a very beautiful plant over there at Newark, and there is landscaping and gardening, and that is included in overhead. What is the situation in that regard, Mr. Watt? A. Landscaping?

Q. Yes.

Mr. Bennett: Now, just a minute.

Mr. Rosenberg (Continuing): Q. Shrubbery, trees and grass and things of that character. What is the acreage of the plant, Mr. Watt?

Mr. Bennett: You mean the plant, or the whole ground, including your holding ponds?

The Court: Proceed, gentlemen.

The Witness: I believe it is 26 acres.

Mr. Rosenberg: Q. Is any substantial portion of that cultivated or improved, or beautified?

A. Not other than our garden. [894]

Q. How big is that?

A. I would say about a quarter to half an acre—I wouldn't know.

Q. Have you figured how much the charge to gypsum per year is for that item?

(Testimony of David Watt.)

A. Say about a dollar or two dollars a year.

Mr. Bennett: A dollar a year or a dollar a ton?

The Witness: No, not a dollar a ton, Mr. Bennett. We could really landscape it at that rate.

Mr. Rosenberg: Q. Let me ask you this, Mr. Watt: Based upon your experience and your accounting knowledge, do you consider that it is proper to include in the cost of production of gypsum the plant and—a portion of the plant overhead? A. I do.

Q. Can you state whether or not that is the practice that has been employed at Newark with reference to the products that are produced there over the years? A. It has.

Q. Has there been any change in that respect during the period that you have been there?

A. No.

Q. Is there any distinction made with reference to the accounting practices employed in the case of gypsum as compared to the other products produced there? A. There is not.

Q. Now, directing your attention to Plaintiff's Exhibit 18, and under the item "Supervision" appearing on the summary sheet, I note that there is a charge of 4 cents per ton in the period July 1, '45 to June 30, '46, and the charge of 4 cents per ton during the preceding 12 months' period, and in prior periods there do not appear to be any charges under that category. Can [895] you

(Testimony of David Watt.)

tell me whether or not supervision in the prior years was charged in some other account?

A. It was. It was charged as an overhead account.

Q. Does that appear in those work sheets?

A. (Referring to exhibit) Note, supervision—

Q. That appears in the work sheet under “Overhead and General Plant Expense”?

A. Yes, it does.

Q. And is designated “Newark Supervision”?

A. Yes.

Q. Now, directing your attention to the third sheet in this group, designated “Overhead and General Plant Expense,” there are a number of items that are designated “West Coast items,” “West Coast general expense, West Coast general supervision,” and so forth. Will you explain what that designation connotes, “West Coast”?

A. Well, I would say that they pertain to the West Coast operations.

Q. What are these West Coast operations?

A. The Newark plant.

Q. And any other plant?

A. Chula Vista.

Q. And any other?

A. Right now the Hollister mine.

Q. Now, as to those West Coast expenses, are they all charged [896] to the Newark plant, or only a portion of them?

A. Only a portion of them.

Q. And is it—the items that appear on that sheet as West Coast, is that only a portion that is

(Testimony of David Watt.)

allocated to the Newark plant or is that the entire West Coast expense? A. This portion—

Mr. Bennett: Just a moment. Here again I don't want to interpose technical objections, but there is a question as to whether this witness is technically qualified on this field of testimony. As I understand the document, these West Coast charges are like the New York office charges, an assessment to the several plants for a certain share of the West Coast overhead.

Now, counsel, do you want to Court to understand that this witness is qualified to testify as to what his company has done in allocating or assigning the West Coast overhead and New York overhead? If he is, why, maybe his testimony is admissible.

Mr. Rosenberg: Q. Let us take the item of West Coast General Expense; what is that?

A. That is a portion of West Coast general expense allocated to the Newark overhead.

Q. Where is that allocation made?

A. We make that at Newark.

Q. You make that at Newark? [897]

A. Yes.

Q. And is that true as to all of the items that are designated there under the caption "West Coast"?

A. It is true to all overhead items, whether West Coast or other.

Q. Those items that are designated as West Coast expense, whether they are of one kind or

(Testimony of David Watt.)

another, do those items represent the entire West Coast expense under the various categories or only the portion of those items that are allocated to the Newark plant?

Mr. Bennett: Just a moment, just one minute here, your Honor. There is another objection I want to make here to save our position and keep it clear for the record, as well as your Honor's consideration. When these documents and things that were prepared by the plaintiff were admitted in evidence, they were admitted solely for the purpose of showing what the defendant claims were costs and expenses. Now, without repeating the details of whether we were or not allowed to verify figures, we have taken this position consistently during the trial, your Honor, and I don't want to shift from it, their merely furnishing these figures and their discussion by the witness is not the best evidence of actually what occurred, and we don't want to be bound by the ipse dixit or declaration of this witness or other witnesses, no matter how honest he may be, because of several factors. We would otherwise be bound by facts and figures in [898] this case that might ultimately reflect the money judgment the Court would render, and so far as those issues are concerned, without us being privileged to verify the figures, and I think that the purpose is manifestly important for another reason; it has already been developed by the defendant's own testimony that they made errors in their computations, and we don't want to have

(Testimony of David Watt.)

this indirect way for the Court to accept figures as binding upon the plaintiffs—

The Court: I thought we had agreed that they would go in subject to any correction here in the future at any time. If there is any doubt about any figures, I wouldn't want anybody to be bound by them.

Mr. Bennett: Well, that would, of course, be the most expeditious way of handling it. I am anxious to do that. My only purpose, your Honor, is to save our position that we are not bound so far as the money judgment in this case is concerned by mere figures that defendant comes in here and offers from the witness stand in this fashion.

The Court: Very well, then, let us take another step. You indicate that your objection goes to the best evidence rule. What do you have in mind?

Mr. Bennett: Of course, under the best evidence rule, you actually prove, and it is our theory the defendant must prove, these raises in claimed cost; they would have to prove it by appropriate evidence. For instance, we are dealing with West [899] Coast allocations.

The Court: Yes.

Mr. Bennett: Now, how this witness can say from the witness stand that this is the correct West Coast allocation is beyond me—

The Court: He didn't say it was correct. He indicated this was the allocation. Whether it is correct or not I will have to try and struggle with that.

(Testimony of David Watt.)

Mr. Bennett: The way Courts ordinarily do that is to require books and records that would show that so at the time of the trial we can cross examine.

The Court: You sent an expert down there and didn't see fit to follow it up. It is well to keep in mind that on account of the nature of the case and all, and its presentation, and resulting from bookkeeping and the method of accounting, when both sides were in the position they were, to have an expert, you weren't concerned about expense, but I have no control of that item in the preparation of the case. Now, if we did have the books here and those that kept them, I don't know whether we would get through in the next three weeks.

Mr. Bennett: Well, it is possible we would not, and it is a practical matter. I have my objection as I have made it, and perhaps so far as this particular case is concerned as to monies due or not due up to date, maybe we can go on and expedite the trial, but—expedite the trial by admitting this [900] evidence subject to correction. However, I want your Honor to see that it is a serious matter, this question of verifying figures, because if we don't have that right then any sort of figures can be submitted and bases, perhaps with honest purpose, but inspired by partisan spirit, and it would deny us the very essence of the contract.

The Court: Is there anyone in your plant who knows any more about these figures than you do?

The Witness: No, I don't believe so.

(Testimony of David Watt.)

The Court: Proceed with this case.

Mr. Bennett: It is my understanding that your Honor is admitting this subject to correction.

The Court: Yes, subject to correction, any correction at any time.

Mr. Bennett: If that is required.

Mr. Rosenberg: Q. Now, Mr. Watt, referring to Plaintiff's Exhibit 17, was that prepared by you under your direction?

A. No, it was not.

Q. Do you know who it was—

A. Pardon me, do you mean this actual sheet?

Q. Yes. A. Oh, yes, it was.

Q. After checking the records at the plant?

A. Yes.

Q. In your opinion, does that sheet correctly portray and [901] reflect the cost of production of gypsum for the years that are designated on the sheet? A. It does.

Mr. Bennett: I object to that as calling for the conclusion and opinion of the witness, incompetent, and not the best evidence, your Honor.

The Court: Going back again, what is the best evidence?

Mr. Bennett: He has asked now the question as to whether this self-serving document they have presented represents the actual proper allocation of cost of gypsum. That is a terrifically broad question, as I understand it, and really putting the witness in your Honor's seat.

The Court: Read the question, Mr. Reporter.

(Testimony of David Watt.)

Mr. Rosenberg: When Mr. Bennett had witnesses on the stand, he took them item by item. I was trying to save time. I thought I could short-cut a little and ask if there were any exceptions and he could mention them and we could go into those items.

The Court: When he is subject to any cross examination, you wish to level at him, I don't see, keeping in mind what we are trying to do, that we can get at it any other way.

Mr. Bennett: If the question is deemed that that is the witness' claim as to the allocation, why. I will not object to that.

The Court: That is all he could do in any event. That is [902] all they are claiming. These figures they are presenting—if I am in error, I will stand corrected.

Mr. Rosenberg: That is our claim, and it is this witness' opinion as accountant for the firm, that those figures properly show the cost of production for the periods reflected.

The Court: Proceed.

A. It does.

Mr. Rosenberg: Q. Would you say the same as to Plaintiff's Exhibit No. 15 covering the period from July 1, 1945 to June 30, 1946 and the preceding 12 months' period? A. I would.

Mr. Bennett: I must make the same objection.

The Witness: I would.

The Court: Let the record note the objection. I will overrule the objection.

(Testimony of David Watt.)

Mr. Rosenberg: I have no further questions—Just one second. Mr. Reporter, you got an answer to that question, did you?

The Reporter: Yes, I did.

Mr. Bennett: Have you finished, Mr. Rosenberg?

Mr. Rosenberg: Yes.

The Court: We will take a few minutes' recess.

(Recess.)

Cross Examination

Mr. Bennett: Q. Mr. Watt, other than the experience you [903] have had in the setting up of this cost accounting system for Westvaco, what other experience have you had with reference to setting up and determining cost accountings as far as the allocation of costs?

A. I don't quite understand that, Mr. Bennett. You said setting up the cost accounting for Westvaco?

Q. Until you went to Westvaco, you had not had the responsibility of setting up or determining cost accounting for allocation of various costs?

A. Oh, definitely. I had that experience in Africa.

Q. In Africa? A. Yes.

Q. That had to do with what kind of business?

A. Palm oil reduction.

Q. What? A. Palm oil reduction.

Q. Palm oil reduction? A. Yes.

Q. That involved the manufacture of a by-product or byproducts? A. No, it didn't.

(Testimony of David Watt.)

Q. The products there were oil made from the palm and cocoanut? A. That's correct.

Q. That's right. How long were you so engaged with that palm oil business? A. Ten years.

Q. Now, you testified on your direct examination that from time to time you made changes in your accounting method so far as the allocation of direct—or the allocation of indirect charges was concerned, one example being the shift from the allocating of the supervisory or overhead phase of your shipping department from the value basis to a tonnage basis, and in your answer to the interrogatories 10E you described a number of other changes in accounting methods so far as allocations were concerned during the period from 1937 on until and including 1946, and you stated the end of your answer to paragraph 10E of plaintiff's interrogatories, "The above changes were brought about upon the advice of competent accountants for the purpose of improving the bookkeeping and accounting records of defendant as related to all products produced by defendant, including gypsum, and to accomplish uniformity of accounting practices between various units of defendant company."

Were these changes made pursuant to advice of outside accountants or did you refer to yourself?

A. No, they were usually made by our New York office.

Q. These changes, then, were made by the New York office rather than yourself?

(Testimony of David Watt.)

A. Oh, definitely, yes.

Q. For example, this change in 194 — for instance, this change that you say was made in June 1945 where miscellaneous shipping expense was changed and allocated to gypsum on a tonnage [905] basis, whereas before it was allocated on a value basis, was that change dictated or directed by your New York office? A. It was not.

Q. That was a change that you, yourself, undertook to make? A. That's correct.

Q. Then when you referred to the statement that the changes were brought about by the advice of competent accountants, you meant you, yourself, as the competent accountant?

A. I believe so in that case.

Mr. Rosenberg: He didn't prepare those answers to the interrogatories.

Mr. Bennett: The interrogatories were signed and verified by Mr. Watt and he testified, as I understood, on Wednesday that he prepared the answers, himself. If I am wrong, why, I will be pleased to correct it, but the witness—

Mr. Rosenberg: He didn't say that.

The Court: What is the fact.

The Witness: What is the question?

The Court: In relation to those interrogatories, did you prepare them?

A. I assisted in that.

Q. You assisted in that? A. Yes, sir.

Mr. Bennett: And you saw them after they were prepared, did you not?

(Testimony of David Watt.)

A. I beg your pardon?

Q. You saw them after they were prepared?

A. Yes.

Q. You signed them, did you not? [906]

A. I did.

Q. And when you signed them they represented your views and opinion as to what they contained, did they not?

A. I would say so, yes.

Q. This change in 1945 as to the method of allocating miscellaneous or indirect shipping expense was made solely because of your recommendation or decision? A. That change, yes.

Q. Now, the first change you mentioned in your answer to interrogatories, and referring specifically to paragraph 10-E, is as follows:

“Prior to January 1, 1944, all overhead expense was allocated on the basis of operating labor and repair labor expense. Commencing January 1, 1944, and until January 1, 1946, general overhead expense was allocated on a combined supervision and operating labor basis.”

Was that decision to make that change yours, or the New York office's?

A. The New York office.

Q. You received specific instructions in writing to do that? A. No.

Q. How were those instructions communicated to you?

A. Usually by telephone or by someone out on the post from the New York office.

(Testimony of David Watt.)

Q. Do you specifically remember receiving instructions from the [907] New York office?

A. I do not.

Q. How do you know that change was made on instructions from New York office?

A. Mr. Cuneo was in the office at that time.

Q. But you were in charge at that time of the office?

A. No, I was the assistant office manager.

Q. You were the assistant in charge of accounting?

A. I was assistant to Mr. Cuneo, who was in charge of accounting.

Q. Then you don't know, except what Mr. Cuneo, told you, as to instructions to make a particular change—

A. I know he got those instructions; otherwise, the change would not have been made.

Q. How do you know he got those instructions? Did he tell you, or did someone else tell you?

A. No, I am quite sure he would have told me.

Q. But you have no distinct recollection on that? A. No, I haven't.

Q. Mr. Cuneo might have made the change for his own purpose? A. No, he didn't.

Q. How do you know that?

A. Because we don't change like that.

Q. Well, you changed your shipping?

A. Yes, but that was not an over-all change like overhead. [908]

(Testimony of David Watt.)

Q. But your statement about this change commencing January 1, 1944 to January 1, 1946 of allocating general overhead expense on a combined supervision and operating labor basis made pursuant to New York office instruction is merely a conjecture and opinion on your part?

A. All right, yes.

Q. The change in maintenance and engineering cost, allocated on a repair basis, was made when? Do you have a copy of this? A. No, I don't.

Q. Maybe I can supply you with one. You can turn to page 5, Mr. Watt. A. Yes.

Q. Look at line 13; it says, "Maintenance and engineering costs were allocated on a labor repair basis." A. Yes.

Q. When did that commence?

A. At the same time, January 1, 1944.

Q. Prior to that time how were maintenance and engineering costs allocated?

A. On a combined operating and repair labor basis.

Q. Do you know why that change was made?

A. I believe it was made pursuant with every other change at the same time.

Q. You just assume that?

A. I know that, too, that it was made then.

Q. You know it was made, but you don't definitely know of your own knowledge that it was made pursuant to any express instructions received from the New York office? A. No.

Q. You, yourself, did not decide to make that change? A. No.

(Testimony of David Watt.)

Q. The next statement is, "Process control and control laboratory costs were allocated on a direct basis with the balance of the costs of these two departments pro-rated over the direct allocation."

Was that method commenced on January 1, 1944? A. Yes, sir.

Q. Prior to that time how was that allocation made?

A. On an operating and repair labor basis.

Q. Do you know the specific reason why that change was made on January 1, 1944?

A. I do not.

Q. The next statement is, "Commencing January 1, 1946 and during the period from that date to and including June 30, 1946, the same procedure was followed with the exception that general overhead was allocated on a combined operating and repair labor basis." In other words, commencing January 1, 1946, you went back to the method and basis of allocation that you had followed prior to January 1, 1944? A. That's correct. [910]

Q. Do you know why that change was made?

A. Made the change on January 1, 1946?

Q. Yes.

A. That was made because of New York office instructions.

Q. Did you receive, yourself, specific instructions from the New York office? A. Yes.

Q. When did you receive those instructions?

A. I believe it was in the middle of 1945, June or July of 1945.

(Testimony of David Watt.)

Q. What was the form of those instructions, written or oral?

A. No, Mr. Cuneo was out on a trip from New York.

A. And he asked us to go back to this basis again.

Q. Mr. Cuneo at that time had been transferred to the New York office? A. Yes.

Q. Did he tell you why he wanted you to go back to that former basis of allocating cost?

A. Yes, he did. He said he wanted all locations on the same basis.

Q. All locations? A. Yes.

The Court: What do you mean by that?

A. Our other plants throughout the country.

The Court: To the other plants throughout the country, he said.

Mr. Bennett: Yes.

Q. He told you at the same time that this change that was put into effect at Newark on January 1, 1945, had developed novelties or differences in allocation at the Newark plant that were not in accord with what the company wanted for its uniform policy throughout the country?

A. No, he didn't say that.

Q. Well, it was the fact?

A. Well, I don't know. He just told us to change to this basis.

Q. And the change which was effected January 1, 1946, was according to your instructions from Mr. Cuneo to put the method of allocating costs

(Testimony of David Watt.)

here on a uniform basis with all of the other plants of the company throughout the country?

A. That's correct.

Q. Did you on January 1, 1946, make a further change on the basis of allocating miscellaneous shipping expense to gypsum? A. No.

Q. In other words, you continued, despite Mr. Cuneo's instructions which you received you say sometime in 1945, you continued after January 1, 1946, to allocate miscellaneous shipping expense to gypsum on a tonnage basis rather than the former basis of value? A. That's correct. [912]

Q. Now, up until June of 1946 and all during the period that this contract that is in suit for the sale of gypsum by your company to Pacific, miscellaneous shipping expense, if any, which was allocated to gypsum according to your method had always been allocated on a value basis, had it not?

A. Yes, it had.

Q. Now, Mr. Watt, I want to ask you in the next few questions something more in detail about this change of allocating miscellaneous shipping expense to gypsum, from the dollar sales basis to tonnage. In addition to the gypsum that your company has sold to Pacific Portland Cement Company, the plaintiff in this case, you also produce gypsum for pharmaceutical, chemical and scientific purposes which you do not sell to Pacific, do you not? A. That is correct.

Q. That tonnage approximates 4000 tons per year? A. About that.

(Testimony of David Watt.)

Q. Or approximately anywhere from one-fourth to one-fifth or one-sixth of that which you sell to Pacific? A. Correct.

Q. That particular gypsum is handled in a different way than the gypsum which is sold to Pacific, is it not? A. It is.

Q. That gypsum is further refined and packed and shipped in different forms than the gypsum which is shipped in carloads to [913] Pacific?

A. It is.

Q. Do you know the type package that some of that gypsum that you sell for scientific, chemical, or pharmaceutical purposes takes?

A. In bags?

Q. Yes. A. Yes.

Q. That is sold in small lots to people all over the United States, isn't it?

A. Well, about two or three customers at the most, I would say.

Q. That is not handled in bulk, however?

A. No.

Q. And it takes different forms of the product, according to your understanding?

A. How do you mean, different forms, Mr. Bennett?

Q. I mean, it is not the same gypsum that is shipped to Pacific Portland Cement Company; it is further refined and further processed?

A. I believe so, yes.

Q. The gypsum that is shipped to Pacific Portland Cement Company is the gypsum that has been

(Testimony of David Watt.)

dried and ground in the drying and grinding part of your plant and then delivered the bulk in the warehouse, and from the warehouse is pumped by a pneumatic pipe system right into the box cars or open cars [914] in which it is shipped, isn't that so? A. That's so.

Q. That practice of handling the gypsum that is sold to Pacific Portland Cement Company has continued in the same fashion and in the same manner ever since this contract has been in force?

A. That's right.

Q. But the gypsum that you manufacture and sell normally goes through a manufacturing process, which is packed in bags and containers and is shipped out to at least several different customers? A. That is correct.

Q. I suppose that gypsum has to meet certain specifications and character requirements, does it not?

A. That I don't know, Mr. Bennett.

Q. Skipping for a moment the gypsum and going to the magnesia products, in addition to producing simple magnesium oxide you produce down there various and sundry derivatives of that product, do you not? A. Derivatives?

Q. Well, perhaps that is an inapt term, but there has been some evidence that there are different types and characters of magnesium products produced. A. Yes.

Q. You have the general product magnesia oxide which is used as fire-retardant and other

(Testimony of David Watt.)

purposes, and you have other magnesia [915] products which are produced, manufactured and refined as your plant at Newark? A. That's correct.

Q. Do you recall the various and sundry types and characters of those magnesia products?

A. I don't. I might know a few of the types, but not the character.

Q. Well, state them here, please.

A. Periclase S-90, Periclase S-93, Lightburn 2661, 2662, 2663, 2664, 2665, all unground; and the same products all ground—Remosil.

Q. Would you spell that, please?

A. R-e-m-o-s-i-l.

Q. What is Remosil?

A. It is a grade of magnesia product. I don't know what it is for. I believe Mr. Melhase testified as to what it was.

Q. Anything else that you now recall?

A. SMO—generally, that is the lot.

Q. When you are producing bromine down at this plant, as you did, with the exception of the period in 1944, is that handled and sold as just one single product, or are there different characters of that product or refinements thereof that are produced and sold?

The Court: Bromine?

Mr. Bennett: Yes. [916]

The Witness: A. Very little bromine sold at all. Most of the bromine manufactured goes into the making of ethylene dibromide.

Q. You make the ethylene dibromide at the Newark plant, too? A. Yes.

(Testimony of David Watt.)

Q. The bromine that comes from these bromine towers after the bittern with the sulphuric acid is added, is taken then to another part of your plant where this bromine product that you have mentioned is manufactured, with the addition of other chemicals, and so forth?

A. It is all in the same portion of the plant, bromine and dibromines are in the same plant.

Q. That bromine operation was one of the principal products produced at the plant while bromine was produced, wasn't it?

A. Yes.

Q. And it is from a dollar sales value and quantity value?

A. Yes, I would say so.

Q. How much weight by tons of bromine were produced during these years that you have shown, relative to the production of magnesium and gypsum?

A. I haven't the figures here. I could get them for you.

Q. Can they be obtained as readily as the figures you obtained here?

A. Yes.

Q. I wish you would do that, Mr. Watt. How was the bromine [917] shipped out? In what form containers or packages was the bromine shipped out?

A. You mean the dibromine?

Q. Yes.

A. In tank cars.

Q. In tank cars?

A. Yes.

Q. That was the only method in which that was shipped?

A. Occasionally in containers.

Q. Small containers?

A. Drums.

Q. Drums?

A. Yes, special drums.

(Testimony of David Watt.)

Q. What about the production of lime in its various forms at your plant? Didn't this Newark plant produce considerable quantities of lime?

A. It did at one time, yes.

Q. Does it still produce any lime?

A. No, we are using dolomite now instead of lime.

Q. Are you using, according to your understanding, dolomite exclusively in this process of treating bittern water? A. I believe so, yes.

Q. As late as 1946, you were allocating certain expenses down there of an overhead or of an indirect nature to the production of lime, did you not? [918] A. Yes, that is true.

Q. According to Exhibit F, which you may turn to, attached to defendant's answer to plaintiff's interrogatories, according to your figures—(Addressing the court): Does your Honor have a copy of this?

The Court: I can follow you.

Mr. Bennett: Here is a copy.

Q. (Continuing): —sub-note 2 has dates with your percentage of allocation of so-called overhead items for the comparative period 1944 to 1946. According to Exhibit F you allocated 7.8 percent to gypsum, 3.1 percent to service accounts, and 9.4 percent to lime, 6.3 percent to ethylene dibromide, and 73.4 to magnesia. That would indicate, would it not, that even as late as 1946, from July 1, 1945, to June 30, 1946, your lime production was considered by you to be more important, and for that rea-

(Testimony of David Watt.)

son charged with a larger percentage of overhead cost than gypsum, isn't that correct?

A. No, I don't think that is quite correct, Mr. Bennett. You said "more important"? I don't see that, at all.

Q. You have charged against line 9.4 percent of overhead.

A. True, but that is based on labor. Labor to these departments has nothing to do with the importance.

Q. Well, certain of these items were based on labor and certain of the items of allocation were based on other methods, as you have just covered in your testimony before, pursuant [919] to these changes you made——

Mr. Rosenberg: You mean certain items of the overhead, Mr. Bennett?

Mr. Bennett: Yes.

Q. (Mr. Rosenberg): Do you understand it that way, Mr. Watt?

A. (The Witness): Pardon me?

Q. Are different methods used for allocating different overhead items?

A. No, not in general overhead.

Q. (Mr. Bennett): Do you mean by that that there has been no change through the years at all in the allocation of overhead items as to the basis?

A. No.

Q. There have been changes?

A. There have been changes, yes.

Q. That is what I understood, and counsel ques-

(Testimony of David Watt.)

tioned the correctness of my statement. Mr. Watt, there is more detail work required in handling your shipping department of this gypsum that is manufactured at your Newark plant and sold for scientific, pharmaceutical or chemical purposes to customers other than Pacific Portland that there is in the handling of the product out of the warehouse by pumping it in bulk into the cars, weight for weight, isn't there?

A. I don't think I am qualified to answer that, Mr. Bennett. [920] That would be for the production department, not for the accounting department.

Q. Well, I think it is more or less obvious from what you have already told us. By the way, magnesia and various of its products are packaged in relatively small packages?

A. No, we have all various sizes of packages.

Q. All various sizes of packages? A. Yes

Q. From small ones to regular gunny sacks?

A. Yes, and also bulk.

Q. Now, I am referring specifically to this change you put into effect on June 30, 1945, on allocating your miscellaneous shipping expense from a value basis to a tonnage basis. At that time what was the value of magnesia per ton? What were you selling it for? What was your quoted price?

A. We have so many different prices for the different products——

Q. Well, in bulk wasn't magnesia sold for approximately \$46 a ton?

(Testimony of David Watt.)

A. I wouldn't say that. We had all different prices.

Q. What were the prices you were selling your magnesia?

A. Off-hand I couldn't recall. I would have to refer to the books for that.

Q. You haven't any idea?

A. We have had some as low as \$45 and we have had some at \$46, and some higher than that.

Q. How high do some of your magnesia products go per ton? [921]

A. Around \$60.

Q. Around \$60?

A. Yes.

Q. Can't you give us here an approximation, or an approximate average of your various and sundry magnesia products per ton?

A. If you want an average, use the \$46 figure.

Q. In other words, let us take that then, an average of \$46: Now, the price you were asking to charge or to have Pacific pay at that time, June 30, 1945, was \$3.76 per ton for gypsum, wasn't it? In other words, the average price or value of your magnesia products, according to your estimate, would be approximately 14 times greater than that of gypsum per ton, isn't that correct?

A. Yes, that would be about right.

Q. Now, on the basis of allocating your miscellaneous or indirect shipping expense on the basis of value, the ratio of charge against the gypsum, at least the gypsum sold to Pacific, should be as 1 to 14, compared to the charge to be made against the magnesia products, isn't that correct?

(Testimony of David Watt.)

A. Yes, that is correct.

Mr. Rosenberg: Mr. Bennett, I think if you checked your arithmetic, you will find you have made a little error. I think 12 would be closer to it than 14.

Mr. Bennett: I am glad to have the correction. I didn't attempt to figure it here with arithmetical certainty.

Mr. Rosenberg: Multiply 3.76 by 12 and you get \$45.12.

Mr. Bennett: All right, we will accept the figure of 12 times greater value for the magnesia products than the gypsum that was sold to Pacific Portland Cement Company at that time.

Q. On that basis, and assuming that we only had down in that plant being shipped out the magnesia products and the gypsum, [922] on the basis of allocating overhead or indirect shipping expenses, gypsum would be charged with 8½ per cent of the total of that indirect expense; isn't that approximately right? A. Yes.

Mr. Rosenberg: What are you referring to now?

Mr. Bennett: I am cross-examining the witness to develop the effect of this change in methods of allocating the expense. We have agreed approximately on values. He says the average value of the magnesia products would be about \$46.

The Witness: I would like to say that this is very rough.

Q. (Mr. Bennett): Well, you said it runs from 30 up to, was it 60 or 80 dollars a ton for magnesia?

(Testimony of David Watt.)

A. To give you a correct average, we would have to go through all our sales prices and average them to give you a correct average.

The Court: There were four figures given and you agreed on an average of 45.

The Witness: 46, Your Honor.

The Court: 46, rather.

Q. (Mr. Bennett): And of course the value of the gypsum at that time I am taking as what they demanded that we pay them, that is, \$3.76. That is about on the basis of counsel for defendant's figures, one-twelfth of the value of the gypsum, or 8½ per cent. Now on the basis of allocating your indirect shipping costs on the dollar value as you did throughout [923] all the years of this contract until June 30, 1945, gypsum then should have borne only 8½ per cent of the total cost as compared to what magnesia would bear, isn't that correct?

A. That is correct.

Q. Now, if you had also the tonnages of the bromine and the lime and these other products you produced there, you would further depreciate and lessen the percentage of gypsum in relation to the total dollar values of goods shipped out through your shipping department, would you not?

A. You could add the lime but not the bromine. It is handled completely separate.

Q. The indirect shipping had nothing to do with bromine? A. It is completely separate.

Q. They had the matter of routing the cars, and so forth——

(Testimony of David Watt.)

A. That is all done in a separate portion of the plant, Mr. Bennett.

Q. You mean that the shipping department had nothing to do with bromine?

A. That is correct.

Q. But did have to do with the lime?

A. Hydrated lime, yes.

Q. And the values of the lime, or at least the manpower efforts in producing it, exceed that on gypsum?

A. No, That is not the lime here. This is quicklime and hydrated lime combined, and we shipped very little quicklime. [824] The quicklime went into this process here.

Q. Let us accept the 8½ per cent figure on the assumption that nothing was shipped but magnesia and gypsum. On the dollar value basis, the gypsum would be allocated 8½ per cent of the total overhead shipment? A. That's right.

Q. When you changed it to a tonnage basis—and the tonnages run approximately equal, there is some difference; in the period July 1, '44, to June 30, '45, you shipped or you sold 39,305 tons of magnesia products and 32,582 gypsum. Now, assuming that all that gypsum that you have listed here as being sold was sold to Pacific—which of course is not the fact—the percentage, switching your system from a value basis to a tonnage basis, materially increases the charge that is made against gypsum, doesn't it? A. It does. It does.

(Testimony of David Watt.)

Q. And raises the percentage about $8\frac{1}{2}$ per cent up to—well, I haven't figured the relation of 32 to 39, but approximately 40 per cent or more.

A. That is correct.

Q. Now, the effect of that change or refinement in your accounting methods, as I understood you to describe it, had the effect of loading onto gypsum a charge that formerly had been borne by your other products, isn't that correct?

A. That is correct. [925]

Q. And so far as the price that Pacific Portland Cement Company would have to pay for the gypsum, assuming that that was a proper charge of the cost of manufacture, that change in method would increase the price Pacific would have to pay for its gypsum during the next period, wouldn't it?

A. It would.

Q. So that change or refinement in your book-keeping process had the effect of substantially shifting the charge from your other products to gypsum, isn't that right?

A. That is correct.

Mr. Rosenberg: You mean as far as indirect shipping is concerned.

The Witness: Yes, indirect shipping only.

Mr. Bennett: Yes. There is no question about direct shipping expense. All the time we have been agreeable to paying that.

Q. You say that change, Mr. Watt, was made solely upon your own volition?

A. It was.

Q. You knew at that time that your company

(Testimony of David Watt.)

was trying to get a higher price for this gypsum?

A. I don't believe I even considered that.

Q. You gave that no consideration at all?

A. I don't believe so. It seemed to me that shipping expense on any other basis than the tonnage basis was absolutely and [926] basically wrong.

Q. Then your company had been wrong for ten long years.

A. I say they absolutely had been wrong for ten years.

Q. The only way in which that affected the company was that it didn't permit the company to get as high a price for the gypsum, assuming that any part of this cost could be allocated to gypsum, and it would under the method you devised in 1945.

A. That is correct.

Q. And isn't it a fact that the only reason you made that change at that time, Mr. Watt, was to add further to the price you thought you could charge Pacific Portland Cement?

A. That is not true, absolutely not. I don't believe I even considered gypsum when that charge was made. After all, gypsum is only one of 40 products that we make.

Q. But isn't it a fact, Mr. Watt, that the cost of handling the gypsum, and the amount, if any, of any supervision necessary to ship that gypsum out in bulk carloads to one customer, pumping it from the warehouse with a pump, and as soon as one car is filled, turning it into another car, that no greater burden was placed on that product in 1945 than before?

(Testimony of David Watt.)

A. I believe that is true. Nevertheless, the supervision charge in previous years had been wrong all the time as far as I was concerned.

Q. Now, as a matter of fact, then, Mr. Watt, the burden of supervising the shipping department, assuming that there is such a [927] burden, with the personnel involved in that, is far greater in the case of handling the magnesium products than the gypsum, the type of gypsum that you sell to other customers, than any amount of supervision that may be incidental to handling the gypsum sold to Portland Cement?

A. That I wouldn't know. That is a problem of our production department.

Q. You didn't investigate that at all when you made this change? A. No.

Q. Weren't you concerned with having a basis of allocation that reflected some truth in actual relationship between the amount of supervision to handle this gypsum you were loading with a new and greater charge——

A. No, the truth of shipping is the tonnage that is shipped. You can't get any closer to the truth.

Q. You knew this contract contained a provision that permitted your company to charge an increased price if during any twelve-month period there was an actual advance in the cost of manufacture of gypsum, didn't you? A. I did.

Q. And you knew for some period of time before there had been a dispute and controversy between your company on the one hand and Pacific

(Testimony of David Watt.)

Portland Cement Company on the other as to the costs of manufacture that should be considered in order to determine [928] whether any actual advance in the cost of manufacture occurred during any twelve-month period, didn't you?

A. I did.

Q. That question was very much in your mind at the time you on your own volition made this change?

A. It was not. I never even thought about it.

Mr. Bennett: Does Your Honor wish to take the usual recess at this time?

The Court: There are a couple of distinguished gentlemen that I anticipate are waiting for me, so we will take an adjournment at this time.

(Thereupon an adjournment was taken until 2:00 o'clock p.m. of the same day.) [929]

Friday, December 26, 1947, 2:00 o'clock p.m.

The Court: Proceed.

Mr. Bennett: So Your Honor will be better able to follow this document, I will hand you Plaintiff's Exhibit 18 which I am going to refer to in the further examination of this witness.

DAVID WATT

recalled as a witness in behalf of defendant, previously sworn.

Cross-Examination (resumed)

Q. (Mr. Bennett): Mr. Watt, have you treated in any different light so far as the allocation of expenses either direct or indirect, either those where you have actual cost records or those where you

(Testimony of David Watt.)

allocate by an arbitrary or related basis any difference between the gypsum that is manufactured and sold to Pacific and the other gypsum which is manufactured in some degree further by further processing and sold to other purchasers for chemical, pharmaceutical or scientific purposes?

A. No.

Q. You just treated all the gypsum alike?

A. Will you say that again?

Q. So far as allocating costs and making charges of costs, you treated all the gypsum you produced down there alike? A. That's true.

Q. And where you say you assign something to gypsum under [930] direct or undirect charge, it refers to total production of gypsum and not merely production of gypsum when the product is sold to Pacific Portland Cement Company?

A. No, in all these cases we were talking about gypsum sold to Pacific Portland Cement Company only.

Q. Do you treat the other gypsum you produce and sell on a different basis so far as assigning or allocating costs? A. No.

Q. You treat it the same?

A. Treat it the same.

Q. So in any of the statements that you have prepared included in the answer to the interrogatories and this form which is Plaintiff's Exhibit 18, where you speak of allocation to gypsum, you mean allocation to all the gypsum?

A. No, I mean allocation to PPC gypsum only.

(Testimony of David Watt.)

Q. How does your allocation to the other gypsum differ from the allocation that you have shown, say, in Plaintiff's Exhibit 18 to the gypsum sold to Pacific Portland Cement?

A. It doesn't differ at all, but this is only the allocation to PPC gypsum shown on this sheet. The other gypsum is not on these sheets at all.

Q. For instance, here under the last page of Plaintiff's Exhibit 18 at the top of the page bearing title "Westvaco Charges per books for cost of production to gypsum, shipping expense, tons produced," and you have given at the top the total tons [931] produced for the several years beginning with the calendar year 1937, and the year July 1, 1945, to June 30, 1946, is this tonnage reflected up there merely the gypsum that has been produced for and sold to Pacific Portland Cement Company?

A. No, that is all gypsum produced.

Q. Including the 4,000 tons or so that you sell to other customers? A. Yes.

Q. For scientific, pharmaceutical and chemical purposes.

A. I don't know what the purpose is, but the tonnage is there.

Q. So that the purpose of allocating cost, you treated that gypsum just the same as you have the gypsum that is manufactured and sold to Pacific Portland Cement Company?

A. In the production figure, yes.

Q. Coming down to the next title on this last page entitled "Shipping Expense," and title "Ship-

(Testimony of David Watt.)

ping Expense, Labor Loading, \$4994.42 for the period July 1, 1945, to June 30, 1946," is that charge, labor loading, only for the gypsum loaded and shipped to Pacific Portland Cement Company?

A. It is.

Q. That would be called by you a direct charge?

A. It would be, yes.

Q. There is no dispute about that, and never has been between your company and our company.

A. I understand that. [932]

Q. The next item is "Power—\$573.20." That is likewise called a direct cost of manufacture considered by you to be a direct cost of manufacture of the gypsum sold to Pacific Portland Cement Company?

A. Yes.

Q. It does not involve labor to produce or refine the other type of gypsum?

A. No.

Q. You say you have a separate account set up for that gypsum in your books?

A. We do.

Q. The cost for producing that gypsum is greater than the cost for producing the gypsum for the Pacific Portland Cement Company?

A. It is.

Q. What?

A. It is. I would like to add that after all this is bulk gypsum we are talking about, and the other gypsum is bags. Therefore, it is a higher cost in the bagging operation.

Q. It is further refined and processed in many instances, isn't it?

(Testimony of David Watt.)

A. No, I don't believe it is further refined and processed. The only process is putting it in the bags.

Q. But it is sold for various purposes, isn't it?

A. I don't know. [933]

Q. You don't know that?

A. I don't know.

Q. You have read the contract in this case?

A. Yes.

Q. Do you recall that refers to the reservation that Westvaco has in California and its successor has to sell 4,000 tons of gypsum for scientific, pharmaceutical or chemical purposes?

A. That is true, but I don't know that that is what it was sold for.

Q. Do you know who it was sold to?

A. I do.

Q. Who was it sold to?

Mr. Rosenberg: To which we object on the ground it is incompetent, irrelevant and immaterial. What difference does it make, Mr. Bennett?

Mr. Bennett: Well, I am not going to press the point although it does seem to me to have a bearing in connection with this matter of cost and charges.

Q. You say you don't know what it sold for before, Mr. Watt? A. No, I don't.

Q. Now, directing your attention again to this last page, "Westvaco charges per Books for Cost of Production to Gypsum, shipping expense"—again you have listed at the top the words "Gyp-

(Testimony of David Watt.)

sum Production," including gypsum you sent to others than Pacific Portland Cement. [934]

A. That's correct.

Q. In this column to the right, headed "T" and under which appears certain figures, for instance, opposite "Labor Loading" for this last period ending June 30, 1946, you have a figure "14." That means 14 cents per ton? A. That does.

Q. Was that figure of 14 cents per ton derived by dividing the total cost that you have noted for labor loading \$4994.42 by the figure 36658?

A. It was.

Q. You have charged, have you not, against the gypsum produced for Pacific Portland Cement Company, the cost of producing gypsum that you have sold to other people, haven't you?

A. No, we have not. This figure here——

Q. Just a minute. You are pointing to the figure \$4994.42 which is for labor loading.

A. Loading the gypsum sold to Pacific Portland.

Q. Yes, but as I understood it, you told me that this figure 14 cents was derived by dividing that total figure of \$4994.42 by the total——

A. By the total gypsum produced.

Q. (Continuing): ——by the total gypsum produced. A. That is correct.

Q. You have done the same thing on all of these items that also appear on that page where the cost per ton appears in this [935] column headed by "T." A. We have.

(Testimony of David Watt.)

Q. (The Court): Pardon me. What is the figure 36658T?

A. That is the tons of gypsum produced in that period.

Q. (The Court): In the bulk?

A. All gypsum.

Mr. Bennett: All gypsum.

The Witness: All gypsum.

The Court: All right.

Mr. Bennett: The bulk gypsum sold to Pacific Portland and other people produced for other purposes and sold to other customers.

The Court: I understand.

Q. (Mr. Bennett): In any event, the costs that you have itemized under the title "Amount" in each of these early periods is divided by the total tons of gypsum produced for all purposes including that sold to other customers.

A. That is correct.

Q. And the result of that division is the figure that you have listed in this third column under the title "T"? A. It is.

Q. Where you have attempted to estimate or set forth the cost per ton. A. That is correct.

Q. Is this figure \$4994.42 the labor that was involved in [936] loading all the other gypsum you produced and shipped to other customers.

A. No, it was not; it was the labor on that PPC gypsum only.

Q. Then, this figure of 14 cents per ton is not a true reflection of the total labor cost of all actual

(Testimony of David Watt.)

shipping on your gypsum, is it?

A. No, this is the PPC gypsum only we are talking about. Mr. Bennett, if we had used the actual gypsum shipped to PPC, then your unit cost would have been higher to PPC because we are giving PPC the benefit of using our total production.

Q. In other words, the cost of labor loading the other gypsum per ton is relatively higher than the cost of loading this? A. That is correct.

Q. Do you keep that is a separate account?

A. It is in a separate account.

Q. That account is available, is it, Mr. Watt?

A. It could be, yes.

Q. You could produce that without any particular difficulty?

A. For what periods?

Q. Say, this last period July 1, 1945, to June 30, 1946. A. It could be.

Q. And the preceding twelve months?

A. Yes, it could be.

Q. The "Power" item of \$573.20 that you have listed there, is that the power that is directly used in loading from the warehouse [937] into the cars the gypsum that is sold and delivered to the Portland Cement Company? A. It is.

Q. And it does not include anything for the loading or shipping of the other gypsum?

A. No, it does not.

Q. That again is considered by you and listed by you in your answer to the interrogatories as well

(Testimony of David Watt.)

as this document, Plaintiff's Exhibit 18 as a direct charge. A. It is.

Q. Now, we come down to the title in brackets "Allocated Expenses" in which you list on this particular sheet of Plaintiff's Exhibit 18, "Demurrage, Shipping Foreman, Shipping Foreman Assistants, Shipping Clerk, Warehouse Labor, Tractor Expense, Labor for Tractor," and you have a total there of \$4859.99. That is the total sum that you have sought to allocate against the shipping of the Pacific Portland Cement Company gypsum for these allocated items of expense, is that correct?

A. Yes.

Q. And each and all of those allocated expenses as they are set forth in this document, Plaintiff's Exhibit 18, are what you consider and have denominated in your answer to the interrogatories as indirect expenses? A. It is, yes. [938]

Q. Now, I notice at the bottom of this particular page the following notation:

"In preparing this schedule on shipping expense, actual labor and power have been shown for the years in question. However, costs of repairs and allocated expenses have been shown in total as it would be impossible at this date to go back to the earlier years and break down the individual items as many of the records are no longer extant."

What do you mean when you say that the allocated expenses have been shown in total in this notation?

A. Just what it says. It is in total, all of these expenses are combined and shown in total.

(Testimony of David Watt.)

Q. You are unable to show or establish from any available records or records that were available at the time that you prepared this document, Plaintiff's Exhibit 18, as to the particular amount of the charge or the basis for the charge of items such as "demurrage, shipping foreman, shipping foreman assistants, shipping clerk, warehouse labor, tractor expense, labor for tractors," is that correct?

A. That is correct.

Q. Let us confine ourselves to this last year of July 1, 1945, to June 30, 1946—what actual demurrage charge was made to you by any railway, railroad or other shipping concern for demurrage on any cars or vehicles for transportation involved in the shipping of any gypsum to or for Pacific Portland Cement [939] Company?

A. I don't know. I would have to go back and check every record we have, every demurrage bill to see if there was such a thing.

Q. Did you do that when you prepared this document?

A. I certainly did not. I didn't have the time or the staff to do that. After all, I understood that PPC was to send down a certified public accountant to do it, and the next thing I knew we were asked to do it, and in the limited time I could spare I got these figures for you.

Q. You didn't find any?

A. I don't know. I didn't check to find any.

Q. Just a moment. You don't know of your own knowledge now or from anything that you ascer-

(Testimony of David Watt.)

tained while you were preparing this document, Plaintiff's Exhibit 18, that there were actual demurrage charges for the period July 1, 1945, to June 30, 1946?

A. I couldn't say whether there were any or not.

Q. With that absence of information you simply arbitrarily assigned a certain percentage of cost for demurrage, was that so?

A. I didn't assign anything for demurrage charges.

Q. Why did you include it in the title, "Allocated Expense Total"?

A. If you look there, the figure is opposite all of them.

Q. This sum of \$4859.99 which you have charged against the [940] production only of the Pacific Portland Cement Company gypsum in that yearly period, July 1, 1945, to June 30, 1946, you can not say as to the amount if any were demurrage charges which the company had to pay or bear for any gypsum cost?

A. No, I can not.

Q. What about the next item, "Shipping Foreman"?

A. All of these items are bracketed together, which means that I cannot say the exact amount of any of these items. That is why they were grouped together and put in as a total amount.

Q. Well, the total amount of these allocated items are almost equal to the total amount of the direct and actual expenses, the labor and power involved in loading.

(Testimony of David Watt.)

A. Could I see one of these sheets, please?

Q. Yes, certainly.

A. In this case definitely it would be because of the allocation being split on a tonnage basis—it definitely would be about the same——

Q. And it makes a much larger figure and it makes a much larger cost than when you formerly allocated it on a value basis.

Mr. Rosenberg: What do you mean by “much”? The figures speak for themselves, don’t they, Mr. Bennett?

Mr. Bennett: I think so.

Mr. Rosenberg: Well,——?

Q. (Mr. Bennett): That is a fact, isn’t it?

A. Well, it is right there, Mr. Bennett.

Mr. Bennett: Yes. The witness, in fact, has said that in his previous answer.

Q. How much did you allocate of this total sum of “Allocated Expenses—Indirect Expenses” to the shipping foremen for the shipping of the gypsum delivered to Pacific Portland Cement Company?

A. How much of this figure is for shipping foremen?

Q. Yes. A. No, I have no idea.

Q. You have no idea at all?

A. No, I haven’t. I have said, Mr. Bennett, these were totaled together.

Q. I know you have said that.

Mr. Rosenberg: What is the use of questioning him then?

The Witness: What is the use of questioning me?

(Testimony of David Watt.)

Mr. Bennett: I think I am entitled to that.

Mr. Rosenberg: Just a moment. The witness said in order to get this material out for Pacific Portland Cement Company, because they did not want to spend the money to do it themselves that in the light of the limitations of time and personnel, he took the total figure which is a correct figure, but he did not have an opportunity to break it up into separate accounts.

The Court: I followed that testimony. [942]

Mr. Rosenberg: Then what is to be gained by taking each separate amount? I will stipulate that the witness will say in the light of the unavailability of the records to him that he could not work each separate item out, and he will say the same with regard to each item.

The Court: I suggest that will be sufficient for our purposes.

Mr. Bennett: Then I will ask him the question, if I may, Your Honor:

Q. The same answer you gave as to demurrage charges, shipping foremen, you would give to the other items, namely, shipping foreman assistants, shipping clerk, warehouse labor, tractor expense, labor for tractor, is that correct?

A. That is true.

Q. When did you first start preparing information for this document, Plaintiff's Exhibit 18, Mr. Watt?

A. I don't remember the exact date. I believe Mr. Rosenberg or Mr. Kaapcke could tell you the exact date.

(Testimony of David Watt.)

Q. It was several months since you started to do that?

A. It definitely was not several months ago. It was a more recent date than that.

Mr. Rosenberg: The record shows it was transmitted by me to your firm on November 24.

Mr. Bennett: I know that. I did not ask him when it was delivered. [943]

Mr. Rosenberg: That is when the work was done.

The Witness: That is when the work was done.

Mr. Rosenberg: When it was completed, I sent it to you.

Mr. Bennett: I will pass that point a minute and maybe we can be of some aid in refreshing the recollection of the witness in that particular.

Q. As I understand it, at this time, today, you are unable to say the percentage of this total sum of \$4859.99 that you allocated for indirect shipping expense for any of these items included under the title "Allocated Expenses," is that correct?

A. I am.

Q. Pardon me?

A. I am still unable to say.

Q. Then this figure just represents a total of what you allocated for these particular indirect items in connection with shipping? A. It does.

Q. And you are unable at this time to furnish any further detail concerning that allocation?

A. That's correct.

Q. (The Court): Why?

(Testimony of David Watt.)

A. It would take so long to work it out and go back to the old records and also some of the old records are no longer available for that. I could quote, for instance, time cards. The ordinary time card is not kept beyond the period of three [944] years by our company, and to take some of this, of what Mr. Bennett was asking for on the shipping clerk, or the shipping foremen, I believe he said, we just don't have the records behind that to get that any longer.

Q. (Mr. Bennett): Mr. Watt,——

(Addressing the Court): Am I interrupting, Your Honor?

The Court: No.

Q. (Mr. Bennett): Mr. Watt, all I am asking about at this particular juncture is the allocation you made for the period July 1, 1945, to June 30, 1946. A. Yes.

Q. You mean to say that you don't have records available to show the amounts and calculations and the basis for these allocations?

A. We have records that far back, yes, but it would take weeks to work it up in the way you people want it and we just have not the staff or the time to do it right now.

Q. It is a fact we sent this form to be filled out by you on October 21 of this year, isn't?

A. I don't know.

Mr. Bennett: Well, counsel, will you stipulate to that fact to save us time?

Mr. Rosenberg: Yes, and I will also stipulate

(Testimony of David Watt.)

from the time I received it, Mr. Kaapeke and I were discussing the matter for approximately two weeks because it was explained to [945] him that certain information he wanted could not be given in the form he wanted and we spent approximately two weeks, and in the meantime he told me he was in conference with Mr. Flick before these sheets could ever be turned over.

Mr. Bennett: You got the sheets on October 21, did you?

Mr. Rosenberg: Yes, but that is only half the story?

Mr. Bennett: There were no further changes made by either Mr. Kaapeke or Mr. Flick after that time, were there?

Mr. Rosenberg: Are you asking me?

Mr. Bennett: Yes.

Mr. Rosenberg: Obviously there were not. But the information was not furnished in the manner requested by you for the reason stated by the witness.

The Court: Let me ask a question in order to clear this up:

Q. You have an item here, "Warehouse Labor," in that bracket. A. Yes.

Q. Now, if you were to consult your books, in what manner would you check that item?

A. First of all, we would go to the distribution cards, each individual man's distribution card and run down every distribution card, maybe 10 or 15 on each individual card and pick out item by item, day by day charged to that account.

(Testimony of David Watt.)

Q. How would that be charged to that account, on an hourly basis or daily basis? [946]

A. On an hourly basis.

The Court: I don't know how they could do more. Maybe it is me.

Mr. Bennett: We are entitled to know what it is.

The Court: But you must keep in mind the conditions under which this sheet was made up, the time and personnel needed. All those things must be considered in determining this testimony.

Mr. Bennett: Your Honor, let me point out this, these are all allocated items.

The Court: I understand that. They did that hurriedly to satisfy you people, in furnishing to you information.

Mr. Bennett: That is the way they claimed the increase and——

The Court: Yes, they claimed that on cards. That is the reason I asked this question. They have cards on an hourly basis.

Mr. Bennett: Let me point this out, if I may, Your Honor, if you will just look up ahead on the shipping expense where the direct labor was involved. That was on the basis of accounting——

The Court: Here is where we get confused and I am not impressed by this—here is a sheet made up hurriedly without consulting the data on which it was based, and that is in the books. Is that correct or not? [947]

Mr. Bennett: That is one of the reasons I did not want to be bound by one of these figures. It now

(Testimony of David Watt.)

appears that even the witness can not determine or tell how much is allocated.

The Court: He does not make any pretense of doing that. [947-A]

Your Honor, let me also clear this point up. The witness has already testified that this particular item, Warehouse labor, that your Honor's attention was directed to, was not an item allocated on a time card basis, but was allocated on a tonnage basis. In other words, they took the tonnage——

The Witness: Mr. Bennett is wrong there. Originally it is allocated on a time basis.

The Court: And then a tonnage basis.

The Witness: And then allocated to gypsum on a tonnage basis.

Mr. Bennett: The point I want to make here, and apparently we are not thinking of the same thing, is that it was not figured as the direct items of labor were figured, and they had apparently to get these figures, the records of the actual amount of labor required in loading and handling gypsum for this period, and we are willing to accept their figures, but when we come down to these allocated items, your Honor, they are not items on which either this document or the witness' testimony—— your Honor said something about a certain sum that has been allocated for warehouse labor. That is what I am trying to find out, and he says he can't tell us.

The Court: I can understand why he can't. That is the point I am trying to develop, and if I am wrong I will stand corrected.

(Testimony of David Watt.)

Mr. Bennett: He said warehouse labor was kept on a [948] time card basis.

The Court: Yes, up to the period they went over to the tonnage basis. Am I correct?

The Witness: Yes, absolutely correct. To begin with, it is based on labor's hours, so much money, and then the money is allocated on a tonnage basis to the various products.

Mr. Bennett: I think your Honor has been confused by this answer of the witness, which is in contradiction to what he first said. Prior to June 30, 1945, he said, these indirect items in the shipping department, of which this warehouse labor was one, was allocated on a value basis. Your Honor remembers that, don't you?

The Court: Yes.

Mr. Bennett: In other words, they took the value of the products that were shipped out of the warehouse, and as the value of, say, the magnesium products bore to the gypsum products, they made this arbitrary allocation. It was not on a direct labor basis at all, even prior to 1945.

The Court: I followed the testimony. It changed from time to time.

Mr. Bennett: But I wanted to correct what appears to be your Honor's misapprehension of the fact that it previously had been allocated on a labor basis. None of your indirect shipments had been allocated.

The Court: I am not laying down any doctrine that it has [949] been constant in relation to this bookkeeping or whatever you wish to call it.

(Testimony of David Watt.)

The Witness: Might I ask Mr. Bennett one question, please?

The Court: Maybe the witness can straighten us out.

The Witness: I don't know what Mr. Bennett means, but you have down here "Warehouse labor," or at least that is one of the headings that your client put on here. Now, that warehouse labor is labor directly determined before it is allocated, so to find out what it is we would have to go over every individual time card of every man in the plant to find out how many dollars we start with before we even commence to allocate.

Q. (Mr. Bennett): Wasn't the warehouse labor in this item of allocated expense labor that had to do with all the warehouse activities, the shipping of magnesium and the other products?

A. Other than direct labor, yes; possibly the **janitor**, or some miscellaneous items.

Q. Yes, it may have been the janitor. Your time card didn't show what percentage of time he spent for gypsum? A. It certainly didn't.

Q. Or what percentage of time he spent for the other things that were shipped?

A. No, it didn't.

Q. In other words, when you got up this sheet, here, you had some figures somewhere in some manner showing that there was an item of warehouse labor that was not directly connected [950] with the manufacture of gypsum, is that correct?

A. Which figure are you talking about now?

(Testimony of David Watt.)

Q. The thing we have been talking about for ten minutes. A. This 4859.

Q. The item of warehouse labor, which is apparently part of that, which you said were allocated in total, as it would be impossible at this date to go back and break down the individual items. I am asking you now if that item of warehouse labor didn't involve some labor that had to do with the handling of your shipping department that was in no way broken down to percentages of of time spent for gypsum or time spent for the other products. A. That is correct.

Q. All right, now, you can't tell us, as I understand it, how much of this \$4859 you allocated to warehouse labor, can you? A. No, I can't.

Q. And the same answer would apply to each of these items on the sheet?

A. Each one of them.

Q. And in addition to that I understand that you don't know whether there were any demurrage charges for gypsum shipments?

A. I didn't say that. I said I wasn't sure. I said I would have to check back and find out.

Q. Do you have any recollection of seeing any demurrage charges for this period from July 1, 1945, up to June 30, 1946, that had [951] anything to do with gypsum?

A. I said I don't know. I don't handle that. That is one of the accountants in the accounting department.

Q. You are in charge?

(Testimony of David Watt.)

A. True, but I don't look at every bill that is paid. I doubt if Mr. Flick does, either. I doubt if we could do our jobs if we did that.

Q. We were furnished this form filled out by the defendant on November 24, 1947. Now, in the event that the plaintiff or some representative of the plaintiff went down to your plant to verify these so-called allocated expenses, would it be possible now to get all of the records and data which would show actually the existence of the basis for this allocation of each of these items?

A. It could be, yes.

Q. How long would that take? A. Weeks.

Q. It would take weeks?

A. Sure. This is done on a **month-by-month** basis, and when you start going over these time-cards, all of these books, every voucher we have got month by month to establish a monthly figure before you get the yearly figure, it would take weeks of work. That is why we haven't done it here.

Mr. Bennett: Your Honor, perhaps, realizes why in the short period we had to send a certified public accountant down [952] there we didn't do that, aside from the expense involved to us.

Q. This shipping foreman that you have in that department is the man that takes care—is the supervisor of the whole shipping department?

A. That is correct.

Q. What percentage of his salary did you allocate in that last period, July 1, 1945, to June 30, 1946, to the production or the cost of manufacture

(Testimony of David Watt.)

of the gypsum that was actually sold and shipped to or for Pacific Portland Cement Company?

A. Cost of production?

Q. Yes.

A. Nothing in the cost of production.

Q. In other words, you didn't consider that the shipping foreman's salary was an item involved in the cost of production of gypsum?

A. It is part of the allocated shipping expense.

Q. What did you mean when you said you didn't consider it cost of production?

A. I thought you meant this cost of production in the top part of the sheet, here.

Q. This direct cost?

A. This direct cost, yes.

Q. You don't consider that the shipping foreman is an actual part of the cost of production of gypsum?

A. I definitely do, an allocated portion. [953]

Q. All right, what portion of his salary was allocated for this year in question, July 1, 1945, to June 30, 1946?

A. It was allocated on a tonnage basis.

Q. Can you tell us what percentage of his salary——

A. Absolutely not. I don't go around carrying in my head the salaries of all of the persons that work down there.

Q. I am not asking you what his salary was. I asked what percentage of his salary——

A. I don't carry the percentages, either. The

(Testimony of David Watt.)

percentage of gypsum is 50 percent of the total tonnage; therefore, we can assume it is 50 percent of his salary.

Q. But you don't know actually whether that part of the allocation which totals \$4859.99 involved half of his salary, or some greater or lesser amount?

A. No, I don't.

Q. By the way, what figures did you use for these several items that you have under "allocated expense" to arrive at this total, this exact total that you have put down, \$4859.99?

A. It is very easy. It is the first two figures deducted from the final figure. It gives you the balance of the allocated.

Q. I don't know that I can follow you there.

The Court: Develop that further.

The Witness: It is the two direct figures, labor, loading and power, deducted from your total shipping expense, gives you your allocated figure. [954]

Q. (Mr. Bennett): You had a record showing the total shipping expense? A. We did.

Q. Did that record you had showing the total shipping expense from which you said you prepared this document, Plaintiff's Exhibit 18, show the amount of demurrage that had been charged?

A. No, it did not.

Q. Did it show the amount of shipping foreman? A. It did not.

Q. Or the other items that appear under "Allocation"? A. Not as such.

Q. How do you arrive at this 4859?

(Testimony of David Watt.)

A. I just told you, by difference.

The Court: On a tonnage basis.

The Witness: I just told you by difference. Here is your total charges to gypsum which, less your two direct charges, gives you that amount.

Q. (Mr. Bennett): Well, as I understand it—perhaps I am not sure I do yet—you had total shipping expense charged against gypsum of \$10,427.61; is that correct? A. That is correct.

Q. Now, you had some direct—you had definite records of the direct charges, the actual labor that was employed in loading the gypsum, and the actual power that was involved in loading the gypsum, and you subtracted simply that sum from [955] the total, and that give you the \$4859.99; is that correct? A. That is correct, yes.

Q. All right, but did your total charge of shipping that you had listed against gypsum, \$10,427.61, show the several amounts of the cost of shipping foreman and the shipping clerk and demurrage?

A. No, it definitely does not. Our books aren't kept like that.

Q. And I don't know how we could have gotten the figures.

A. Well, after all, we got them, and we keep our miscellaneous shipping expense in one account, irrespective of whether it is labor, supplies, or what-not, and the total each month is split over all the products on a tonnage basis, and to get these figures you are asking for we would have to go every month, every voucher, every time card, and identify every charge into that account.

(Testimony of David Watt.)

Q. You more or less have to do that if one is to arrive at any accurate or actual cost, don't you?

A. Why? This is the detail requested by you. We can reach an accurate cost without going into that detail.

Q. The details requested by us followed the details outlined in your answers to the interrogatories——

A. I don't know——

Mr. Rosenberg: They certainly don't, Mr. Bennett.

A. (Continuing): ——I have never seen these before.

Q. (Mr. Bennett): Let me cover it this way——

A. I would like to know where these come from, as a matter of fact.

Q. That has been shown by Mr. Flick's testimony, if you listened to it.

A. I wasn't here then.

Q. All the years you have been keeping your cost figures you have considered these items under "Allocated expense," "Demurrage," "Shipping foremen," "Shipping Foremen assistant," "Shipping clerk," "Warehouse labor," "Tractor expense," and "Labor for tractor," as indirect shipping expense?

A. I didn't list these. You listed these.

Mr. Bennett: Will you please read the question, Mr. Reporter?

(The reporter read the question.)

Q. (Mr. Bennett): As indirect shipping expenses, have you not?

A. Which items?

(Testimony of David Watt.)

Q. Well, I just read them, the items that are listed here as allocated expense, demurrage, shipping foremen, shipping foremen assistant, shipping clerk, warehouse labor, tractor expense, and labor for tractor.

A. For instance, I would like to know where this came from. I didn't say there was any demurrage in there.

The Court: Where did it come from, do you know?

Mr. Bennett: It came from the other side, the defendant. [957]

The Witness: Where?

Mr. Bennett: Well, we will show that in a minute. I am informed, if your Honor please, that when in January, 1944, Mr. Flick visited the plant of Westvaco, Mr. Cuneo, the predecessor to Mr. Watt, informed him that they classed and listed as allocated expense in the shipping department the items that appear on the form, Plaintiff's Exhibit 18. Now, if there is any question of that being the fact. I will withdraw this witness and ask Mr. Flick to go back on the stand, but I don't know that that is particularly necessary.

Q. Let me see if I can clear it in this way. Showing you again this last sheet of Plaintiff's Exhibit 18, entitled, "Westvaco charges per books to cost of production of gypsum shipping expense," all of the items appearing in there constitute all of the items that you had charged against shipping

(Testimony of David Watt.)

expense for this gypsum shipped or sold to or for Pacific Cement Company?

A. Yes, in this total amount, here.

Q. Right, but are there any other items——

The Court: Just a moment, "on this total amount here," for the purpose of the record what is that?

The Witness: This total, \$10,427.61.

The Court. All right.

Q. (Mr. Bennett): Are there any items that do not appear on this particular sheet of this Plaintiff's Exhibit 18 entitled [958] "Shipping expense" that you have ever considered under the title "Shipping expense" that you have ever considered under the title "Shipping expense" in the allocation of costs against gypsum sold to Pacific Portland Cement Company?

A. Could I have that question again, please?

Mr. Bennett: Read it to him, please.

Mr. Rosenberg: You mean any type of expense not shown on there? Is that what you mean?

Mr. Bennett: Any type of shipping expense charged or allocated to gypsum does not appear on that document. A. I would say no.

Q. In other words, the items that appear on this sheet entitled, "Shipping expense," in Plaintiff's Exhibit 18 are all of the items, both direct charges and indirect charges, that go to make up any shipping expense you have ever considered as a charge against gypsum sold to Pacific Portland Cement Company, is that correct?

(Testimony of David Watt.)

A. Well, the probable items.

The Court: Is this the total charge?

The Witness: No, your Honor. I understand he is asking me if these are all the items. I have already said that I do not know, because these have not been checked. There may not be any demurrage. There may be something else in there, so I say they are the probable items.

The Court: All right. [959]

Mr. Rosenberg: Is there any question about the total, Mr. Watt?

The Witness: None, whatever. The total we will stand on.

Mr. Bennett: I am entitled on cross-examination, I think, to ascertain how he gets that total, and that is what I am trying to do.

The Court: Let me call this to your attention: These various items that we are examining on now were hastily gotten together.

Mr. Bennett: Yes, your Honor.

The Court: He simply tells us he is unable to check those in the manner in which you wish him to check them, namely, back to the source in detail.

Mr. Bennett: Well, as long as it is definite—

The Court: Am I correct or mistaken about that?

Mr. Rosenberg: I think I could straighten Mr. Bennett out on that.

Mr. Bennett: Your Honor, I am afraid that the point has been entirely missed about this thing.

(Testimony of David Watt.)

A demand for a raise has been based on this thing——

The Court: I understand that.

Mr. Bennett: They must have gone through this——

The Court: He says he didn't.

Mr. Bennett: How then can they claim a right to a raise? [960]

The Court: I am not keeping the books for either side. That is not my purpose here.

Mr. Bennett: The burden in this case, if they demand a raise and purport to show it, is to prove it.

The Court: You both answered ready for trial, gentlemen, and that is what I am trying to do.

Mr. Bennett: That is what I am trying to do.

The Court: You are trying to do the impossible, you are trying to go back to the source of the information that isn't here, and he says it is not here and he can't do it.

Mr. Bennett: Your Honor, let me suggest this to you, and then I will stop. The reason I do this is because I fear through my own failure the court has not got the point I wish to make. We are confronted by a demand for a price increase. We are told there has been an actual advance in cost. They furnished us figures. Now, to furnish those figures, your Honor, they must have had to dig out the facts and base them on something.

The Court: Here is the parting of the ways.

(Testimony of David Watt.)

I follow that clearly. What was the first date these figures were—that is, what we have got here——

Mr. Bennett: This price raise was first presented to us on September 13, 1946.

The Court: That isn't what we are talking about now. We are talking about the subject under examination. [961]

Mr. Bennett: I know, but, your Honor, those figures are purported to be the same as the figures they calculated over *a ago*. Remember, this third price raise that was demanded of us was demanded on September 13, 1946. They said, "Gentlemen, our costs, there has been an actual advance in our cost of manufacture of this gypsum that we have contracted to sell you, and this amounts to a certain figure, 86 cents per ton." Now, we have shown here by our witnesses, and I think it will be—we have shown here by our own figures that this 86 cents—there was actually 25 cents, according to their own assertion, of actual direct charges, and there is a balance in dispute here of some 45 cents.

Now, at that time, in order to base that charge, the defendant had to, if it did honestly and properly, had to determine, and determine actually, what the facts and figures were, so I think this court must assume that at that time, over a year ago, they had the figures, and they had the breakdown and detail. They couldn't have just drawn them out of the air with some rough approximation, but would have had to go into this thing in detail,

(Testimony of David Watt.)

just as any business concern would in determining their costs, so the court must assume, I submit, that this work was done to the point of allowing them to figure down these costs to the fraction of a dollar, that they went over these records and were able to say, "This is the cost for this indirect item, and this is the cost for that indirect [962] item."

Now, they come into court, and counsel, as part of his case, attempted to show your Honor that actually in the last 12 months' period *from 30, 1945, to July 1, 1946*, there was an actual increase of 86 cents, of which 46 cents amounted to indirect properly allocated charges. Now, obviously, I am entitled on this cross-examination to determine what they are, and if the witness says, "Well, I can't tell, I don't know whether they are there"——

The Court: He not only says that, but he tells you why. How is this court going to change that situation?

Mr. Bennett: Upon that basis I submit this court can't allow a 46-cent price increase, and if the question of indirect charges be considered by this court proper to allocate——

The Court: We haven't met that phase of the case.

Mr. Bennett: I thought we were right in it. I thought your Honor stated that the whole case turned on this witness' testimony.

The Court: I said that it was an important point. This is the gentleman that was responsible

(Testimony of David Watt.)

for this charge. That was the only thing I had in mind on that, not taking that as any more important than any other witness.

Mr. Rosenberg: Your Honor, may I just comment on Mr. Bennett's statement, because the thing is being put in a completely false light. [963]

The Court: You may.

Mr. Rosenberg: In September, 1946, we sent them a letter and a notice that our costs had gone up. We had our records then. We have them now, and they are available to them any time they want to go over them and ferret out these things, but they are saying this, and Mr. Flick must be getting a kick out of this, because I am sure he knows the answer better than I do, or Mr. Bennett does. They say, "You carry an account on your books. Let us take, for example, Supplies, and in the regular course of a business concern you will end up at the end of the month with X dollars for supplies," but they say, "Now, we say when your price—we say your price didn't go up." And they file a suit for that purpose, and it is their burden to show it didn't, and our burden to show that it did.

They say, "You have an aggregate amount of supplies, but we want to know how much typewriter ribbon you bought, how much of this you bought, how much writing paper, how much of a hundred and one different items."

We say, "We don't keep our books that way, but the basic records are there. It could be devel-

(Testimony of David Watt.)

oped, but that is not the way a business concern keeps their books.”

Mr. Bennett would have that appear, that we are guessing at figures, but we aren't guessing at figures. Our books would reflect those figures. We haven't them in the convenient form he would like to have them, and he doesn't want [964] to go to the expense of getting them, and he argues to the court that we have the burden. We have no burden to keep our books as he would like to have them kept. I understand how those books are kept, and Mr. Watt has explained it, that as the charges come in they are taken and allocated and you end up at the end of the month with a total figure. If anybody wants to, the Internal Revenue Department, or anybody else, they can go back to the original records and see whether those total figures are correct, and Mr. Bennett has the same privilege, but it is a little too expensive for him, so he wants us to assume that responsibility, and I say we are not under that responsibility, but that does not mean that our books are not properly kept, and that does not mean that it was not supported by our books. It is, and if they want to ferret out the original records and the source from which we keep our books, in good and businesslike fashion, that is their burden, and I don't want it pictured to the court that because we can't come up with the precise figures that would suit Mr. Bennett there is anything wrong with our bookkeeping. I invited Mr. Flick one day in my office to go over our books,

(Testimony of David Watt.)

and he didn't do it, and they are criticizing us because we haven't done the work and incurred the expense that is their responsibility as plaintiff in this suit.

The Court: You may be sure I will not do it. Gentlemen, we will take a recess.

Mr. Rosenberg: And I am sure I won't.

(Recess.) [965]

Mr. Bennett: Without any purpose of prolonging the time of this trial, I feel, however, I should say something so that my silence is not taken as a confession of agreement with what counsel has just said. It is not our theory, and if the question need be argued now, I can furnish Your Honor with ample authorities that in cases of this kind with the issues such as are presented to Your Honor, that it is not our burden to disprove the claimed amount of increase. The affirmative of that feature is upon the defendant. I want to state that position. I thought I had stated it before and I don't want the Court to feel that we are laboring forward here on any theory that the burden is upon us to disprove the fact that an increase has not occurred or that it has in an amount beyond that which actually occurred. I feel I should make that statement so the Court at least is not laboring under any misapprehension of our position. It would indeed be anomalous in a situation of this kind if such a burden were cast on the plaintiff. It would mean in effect, and that is all I interpret counsel's statement to be, that they can come along

(Testimony of David Watt.)

and tell us, "You have an increase of 86 cents," and it is up to us to accept their figures for it. That would put plaintiff or any person in the contractual situation of the plaintiff here in a very untenable position. We would just have to accept their arbitrary allocation of costs and that would be beyond our power to do that.

Now, I am going to ask Mr. Watt this question:

Mr. Rosenberg: Mr. Bennett, I might suggest to you that is not true at all. All you have to do is not pay us. We would have to sue you and we would have the burden of proof, but here you have brought this declaratory suit, and we understand each other. So if we are going to argue, I would want to argue this very fully.

Mr. Bennett: I recognize very readily where you would like to take the position where you would immediately cancel the contract. We are concerned with the continuation of the contract and our performance under it and the reason we sought this declaratory relief is because that is the only way in which this difference could apparently be resolved.

But I don't want the Court to feel for a minute that it is our burden to disprove the increase or establish the exact amount of the increase. That is the burden of the party having the affirmative on that issue and that is the burden of the defendant.

Q. Mr. Watt, when Mr. Flick and Mr. Bannard visited your plant the last time and consulted with you and went over the details concerning the third or last increase of 86 cents per ton, you told both

(Testimony of David Watt.)

Mr. Flick and Mr. Bannard that you would not permit them to examine your books other than those that strictly pertained to gypsum production, at least, you told them that they could not examine the books showing the total tonnage or price or details of the sales of both quantity and amounts of products [967] other than gypsum, isn't that correct?

A. Mr. Flick was not there. Mr. Flick never visited the plant with Mr. Bannard that I recall. I did tell Mr. Bannard that, but I also told Mr. Bannard at the same time that we would be glad to give him a certified statement for any figures that he wanted.

Q. You would give him a certified statement for any figures he wanted?

A. A certified statement.

Q. And you were prepared at that time to give him a statement that would have both basis and details of allocation of all of these claimed indirect items of shipping expense, were you not?

A. That is correct.

Q. And that was over a year ago?

A. That's correct.

Q. Since that time records and books of the details you were then prepared to furnish Mr. Bannard have become unavailable?

A. Not at all. I didn't say we would give him this detail. I said we would give him the basis of allocation which was tonnage or dollars.

Q. But the figures on which those bases were computed such as the portion of the shipping fore-

(Testimony of David Watt.)

men and the shipping foreman's assistant and the shipping clerk and the warehouse labor and the tractor expense and labor for tractors, you were prepared at that time to give him the details. [968]

A. I was not—not in that form.

Q. Well, in the form that would actually reveal how and why you made those allocations totaling altogether \$4859.99.

A. No, I never thought of it in that way at all. The certified statement, when I made that offer,—to me a certified statement was a statement showing total miscellaneous shipping expense—total—and the basis on which it was allocated to the various parties.

Q. You mean the basis, the percentage—

A. The tonnage.

Q. Yes, and the percentages that were assigned to gypsum.

A. Right.

Q. But you did not agree to furnish and you were unwilling to furnish to him at the time the figures behind that basis, that is, showing the actual amount of production and sale of the other products?

A. That is correct.

Q. That furnished to you the basis for your allocation?

A. That's correct.

Q. How did you expect or anticipate Mr. Barnard to be able to determine the correctness or the propriety of the allocation if you were not willing to furnish him the figures on which he could make such a calculation?

Mr. Rosenberg: He just said he was willing to give him the basis. [969]

(Testimony of David Watt.)

The Witness: I told him I was willing to give him this certified statement.

Q. (By Mr. Bennett): I understood you to say you would not give him that.

A. I was willing to give him a certified statement.

Q. But you were unwilling to have him check your books?

A. I don't think he has a right to see anything about other products.

Q. But in order to determine the propriety of any allocation, if allocation at all is proper, one would have to know what the total amount of production of all of the items and the total amount of the sales or the data on which any allocation was based, would he not? A. He would.

Q. And those were details you were unwilling to furnish Mr. Bannard?

A. No, I said I would furnish him with a certified statement.

Q. You said you would furnish him with a certified statement showing total sales of other products? A. No, total only.

Q. You mean merely the total you had allocated as overhead?

A. We are talking about shipping expenses, aren't we?

Q. Yes.

A. That total of the miscellaneous shipping expense and the total of gypsum sold and the total of the other products sold. [970]

(Testimony of David Watt.)

Q. On value as well as——

A. On value or tonnage, whichever it was.

Q. Yes? A. Yes.

Q. But to verify that certified statement you were unwilling to have him go behind that certified statement.

A. After all, a certified statement from a certified public accountant does not need any verification.

Q. You were not a certified public accountant?

A. No.

Q. Did you offer to have a certified public accountant at your expense furnish such a statement?

A. That is what it would mean—a certified statement. I don't think a statement by me would have meant anything.

Q. I read from the statement that you appended to this item of shipping expense:

“It would be impossible at this date to go back to the earlier years and break down the individual items because many of the records are no longer extant.” How would a certified public accountant be able to verify the basis of your allocation?

A. Are you talking about these last two years or the periods in dispute?

Q. I am talking about the two periods in this case, the period of the second claimed raise, the calendar year 1943 over the calendar year 1942, and the calendar year of July 1, 1945, to June 30,

(Testimony of David Watt.)

1946, over the similar period immediately [971] preceding.

A. The records are still available for July, 1944, to June, 1945, and July, 1945, to June, 1946.

Q. Are they available for 1943 and 1942?

A. No, some of the time cards are not there. We only keep time cards three or four years.

Q. So it would be impossible for an accountant, even if he were an outside certified public accountant, to verify the allocations that were involved in the second price increase period.

Mr. Rosenberg: Are we talking about shipping expense?

Q. (By Mr. Bennett): I am talking about all allocated expense as far as records are concerned.

A. As far as time cards are concerned, it would be impossible.

Q. It would be impossible?

A. It would be impossible for time cards.

Q. You knew ever since 1943 when you sent that notice of second price increase of 76 cents, that that matter was questioned and was a matter of dispute continuing down to the present time, did you not? A. I knew, yes.

Q. Were those records destroyed properly or through inadvertence?

A. Definitely not. The regular procedure is we keep them for a certain length of time.

Q. And then they are destroyed? [972]

A. And then they are destroyed. If you kept

(Testimony of David Watt.)

your records all the time you would need a huge warehouse to keep them all in.

Mr. Bennett: I refer, Your Honor, to this shipping expense page of this Exhibit 18 that you have before you.

Q. Were these items entitled "Allocated Expense" totaling \$4859.99 allocated only on the basis that the gypsum sold and delivered for Pacific Portland Cement Company, was that figure determined on the total basis of all of the gypsum produced?

A. No, only on the gypsum shipped to PPC.

Q. However, the arithmetic that appears on the column under the word or letter "T" amounting to 13 cents per ton, for that item, is arrived at by dividing that total into the total tons of gypsum produced, is it not?

A. That is correct. I already pointed out if we used only the gypsum shipped PPC you would get a higher cost per ton.

Q. Do you know what portion of time, for example, of the shipping foreman that he devoted to handling the shipment of all of this other gypsum that you sold to other customers and sold not in bulk, but in bags and other packages?

A. I do not.

Q. This allocation of the shipping foreman's time or expense that you allocated to the Pacific Portland Cement Company gypsum is just an arbitrary allocation, is it?

(Testimony of David Watt.)

A. No, it was allocated on a tonnage or a sales basis.

Q. Yes, but it was not allocated on any basis that you had [973] from records or otherwise of the actual amount of time that he spent, or the relative time he spent in handling Pacific Portland Cement Company gypsum and what he spent in supervising the other shipping operations of the company.

A. It would be impossible for a shipping foreman to keep his time on that basis.

Q. And for that reason of impossibility you simply made this allocation on the tonnage basis, is that correct? A. Yes, that's correct.

Q. And that tonnage basis of allocation was first put into effect June 30, 1946? A. 1945.

Q. 1945, yes—is that correct? A. Yes.

Q. Now, would you say the same thing as to the shipping foreman's assistant and the shipping clerk and the warehouse labor that is under this title "Allocated Expense," that you thought might be a janitor? A. Yes, it is on the same page.

Q. And the same thing with regard to tractor expense and labor for tractor?

A. That's correct.

Q. I note from the figures furnished on Plaintiff's Exhibit 18 that in the period July 1, 1940, to June 30, 1941, when 32,000 tons of gypsum were furnished, the direct charges for labor [974] loading, power, actually and directly put into the gypsum operation, as you say, affecting only the Pa-

(Testimony of David Watt.)

cific Portland Cement Company gypsum, amounted to \$1488.19, whereas such total charges for the period of July 1, 1945, to June 30, 1946, amounted to approximately \$5400. I note as to these so-called allocated or indirect items the first period, namely, July 1, 1940, to June 30, 1941, amounted to only \$1232.13, whereas you have allocated in the last period, namely, July 1, 1945, to June 30, 1946, a total of \$4859.99, or over three times more for these indirect items than you had for the period 1940 to 1941. Can you tell us, Mr. Watt, why your allocated expenses merely in the shipping department increased over three times in those two periods?

A. I would say the cost of labor and materials have gone up so much that they would have to increase that much.

Q. Well, the cost of labor and materials actually employed in the loading of direct labor charge in the loading of gypsum only went up approximately \$1,000, or less than one-third or less than one-fourth, whereas your overhead charges have gone over three times.

A. I wish you would give me the sheet so that I can follow you.

Q. Yes, certainly.

A. Point out the figures in this?

Q. This figure here for the first period for July 1, 1940, to June 30, 1941. [975]

A. This figure here compared with this figure here?

(Testimony of David Watt.)

Q. Yes.

A. As I have already said, the last figure of \$4859.99 is based on tonnage while this one here is based on dollar basis.

Q. And that reflects a many-fold increase in the so-called allocated indirect items.

A. It does. [975A]

Q. In any of the other products that you produced at Newark was there involved as there is in this case a contract or an agreement or any basis whereby the price to the purchaser of those products is determined upon an increase in your actual cost of production?

A. No, I can't think of any.

Q. In other words, this particular sale of gypsum to Pacific Portland Cement Company is the only situation of any customer of your Newark plant where a price to be paid by the purchaser is affected by an increase or a decrease in the cost of production? A. It is.

Q. You understand that in this case there is no decrease or lowering of the price, but if changes occur there is an increase? A. I do.

Q. And you also understand, do you not, that in this case if prices go down one year and then the next year they go up, that your company claims an increase in price for that increase that occurs in the second comparative period?

A. I understand that, yes.

Q. But where the prices go down during that

(Testimony of David Watt.)

12-months period, Pacific Portland is not entitled to any decrease in its prices? A. That is so.

Q. As a matter of fact, the direct cost of producing the gypsum [976] has not materially increased per ton over the base period of the original year when this gypsum was produced and the last period that we are talking about, the 1945-6 period, isn't that so?

A. Well, I wouldn't know. You can see from these sheets, I can't recall these figures.

Mr. Rosenberg: This is strictly argumentative, if the Court please. I suppose Mr. Bennett is now going to ask what the exhibit contains, and the exhibit is the best evidence.

The Witness: It is all stated there.

The Court: All we are concerned with here is the ultimate facts, gentlemen. The documents speak for themselves.

Mr. Bennett: That is true, your Honor.

Q. All these figures that appear in the summary to Plaintiff's Exhibit 18 were inserted by you or under your direction? A. They were.

Q. Showing the direct costs as well as the claimed so-called indirect costs for each year, beginning with 1937 and ending with the period July 1, '45, to June 30, '46? A. They were.

Q. Now, I direct your attention to the page of Plaintiff's Exhibit 18 having to do with "Direct charges," and you will notice under the title, "Materials and Supplies Operations," which is listed under "Direct charges,"—

(Testimony of David Watt.)

Does your Honor have that sheet? [977]

The Court: 18?

Mr. Bennett: It is on this page, sir. This is the new one, the direct charge.

The Court: Direct charges?

Mr. Bennett: Yes, directing his attention to the item "Materials and Supplies Operations."

The Court: Yes.

Q. (By Mr. Bennett): There appears here from your figures an increase in the last two comparative periods of 3 cents per ton in the items, "Materials and Supplies Operations."

A. That is correct.

Q. You notice that? A. Yes, uh-huh.

Q. Included in that 3 cents, 2 cents of which the plaintiff is not disputing, is 1 cent for the use of a low-pressure air compressor, is that not a fact?

A. That is correct.

Mr. Bennett: That does not appear on the document, itself, your Honor.

The Court: I understand.

Mr. Bennett: I will have to go briefly into the facts of that so that your Honor will have them.

Q. Up to March, 1945, this charge for the low-pressure compressor was always included in the general plant overhead expense, wasn't it? [978]

A. It was.

Q. And commencing in March of 1945 you changed your accounting system so as to assign that item of direct charge of expense, is that correct? A. That is correct.

(Testimony of David Watt.)

Q. Now, why was that done?

A. Well, we found that part of the cost of this low-pressure air compressor was being applied as overhead to products and accounts that had no benefit at all from the air compressor, so at that time we had the maintenance department give us an allocation to the correct accounts where this air compressor should be charged, and when we got that we changed it from overhead charge to direct charge.

Q. In other words, prior to '45 you had always charged this low-pressure air compressor to other items of production?

A. All over the plant as an overhead charge.

Q. And then in '45 you changed it so as to eliminate that charge as to certain other items?

A. That is correct.

Q. And made it as a direct charge against gypsum?

A. Well, more than gypsum, many other accounts, but gypsum was one of them.

Q. What percentage of the total cost of operating that low-pressure air compressor was charged to gypsum?

A. Off-hand, I don't know right now. I could find out, but it [979] was very, very small. Off-hand I don't know.

Q. This question was presented when Mr. Bannard's deposition was taken?

A. I don't know.

(Testimony of David Watt.)

Q. You were interrogated when Mr. Bannard's deposition was taken as to this charge?

A. I was not.

Q. Don't you remember the conversation between you and Mr. Kaapeke when your own counsel turned and asked why it was that this change was made in the air compressor charge?

A. I told you that there was change, but that is all.

Q. So that we are not arguing about unnecessary things, you know there was this question about this assignment or allocation of this air compressor sometime previous to this trial,—didn't you?

A. Oh, yes.

Q. But you haven't ascertained since that question was first raised the basis for allocating that expense as a direct charge against gypsum?

A. I had no reason to. I still think it is a correct charge against gypsum.

Q. But the percentage of the total cost you don't know?

A. Off-hand I don't know. I don't carry these figures in my head.

Q. Could that figure be ascertained? [980]

A. It could be, yes.

Q. To what other products do you assign it as a direct charge?

A. I believe if you look on that summary sheet of Mr. Bannard's you will find it right there. Mr. Bannard developed that in his column of differences.

(Testimony of David Watt.)

Q. Now, let me ask you this: Isn't it a fact that before you made this change in 1945 you assigned only 5 to 6 per cent of the cost of this air compressor in General plant expense to be charged to gypsum?

A. That I don't know. I haven't worked the figures out.

Q. I am trying to refresh your memory by the only knowledge that we have about it.

Mr. Rosenberg: Isn't that the percentage of general overhead that was charged to gypsum there? If that was in General overhead that would be the percentage charged.

Mr. Bennett: Yes, I assume that is approximately right.

Q. Now, since you made this change, the percentage of this so-called air compressor that you have charged against this gypsum as a direct charge is from 18 to 20 per cent of its total cost, is that not a fact?

A. Again I don't know if these figures are correct, but it definitely would increase.

Q. Well, there has been about a four times increase as a result of that change?

A. That is quite possible. If gypsum actually uses that they [981] should be charged for it.

Q. Why did you allocate 18 to 20 per cent of the cost of that low-pressure air compressor as a direct charge against the production of gypsum you sold Pacific Portland Cement Company?

(Testimony of David Watt.)

A. I didn't hear all that question. Would you repeat it, please?

(The reporter read the last question.)

A. Because that is the amount that should be charged.

Q. Upon what basis do you make that statement?

A. The basis that we got from the Maintenance Department for the use of the low-pressure air compressor.

Q. In other words, you got some estimate from them that they considered that would be approximately the charge they thought ought to be assigned to gypsum?

A. That is correct. I don't know any other way you could do it.

Q. For a great many years you included it in General plant expense and assigned five or six per cent to the gypsum cost?

A. True, but you can do something wrong, and there comes a time when the wrong should be corrected.

Q. And that correction had the effect in your accounting of increasing the cost of production or manufacture of gypsum?

A. That is correct, one cent per ton.

Q. For that comparative period?

A. One cent per ton.

Q. But you don't know of your own knowledge why or how this 18 or 20 per cent figure was arrived at?

(Testimony of David Watt.)

A. I would say through a time study by the Maintenance Department. [982]

Q. You didn't make any such time study?

A. I did not.

Q. When you made that change as to the second comparison period did you note back for comparative purposes the same charge in the earlier comparative period? A. I did not.

Q. Well, that has the effect, then, of an arbitrary or bookkeeping increase of so much per ton, in this case 1 cent per ton, in the cost of manufacture of gypsum, doesn't it?

A. No, I don't think that is the case.

Q. Well, so far as the comparative period is concerned, and in considering your two methods of keeping your books——

A. No, not at all. If you change your accounting then there is definitely changes in the cost of production of all products.

Q. Yes, so the comparison by which you figured or calculated there would be a 1-cent increase was based upon this change from allocating five or six per cent of the cost of its operation, the operation of this air compressor, to 18 or 20 per cent, is that correct?

A. I wouldn't say it was a change. I would say it was a correction, a correction of a bad allocation.

Q. What is that?

A. A correction of an allocation that was previously wrong.

(Testimony of David Watt.)

Q. In any event, there was such a change made?

A. There was, yes. [983]

Q. Now, was that change made pursuant to any instructions you had from your New York office?

A. No, it was not.

Q. It was made on your own—— A. Yes.

Q. ——volition? A. It was.

Q. And you realized when you were making that change that would, at least so far as your accounting system was concerned, add to the price of gypsum that Pacific would have to pay?

A. I did not.

Q. Then why did you go to the bother of making the change?

A. Mr. Bennett, gypsum is only one of many products.

Q. In the case of gypsum, there is a third person interested, and in the case of other products there is only your own company interested.

A. That is true. On the other hand, I was not thinking of Pacific or Portland, when I was making the change. As a matter of fact, how could I tell what it would do to the cost of production when I made the change? You can tell when you make an accounting change what the difference will be in the cost of production. It is only when you work it month by month that you can tell what the change is.

Q. When you multiply four times an item by a change in the method of accounting, it usually results in reflecting an increase, [984] doesn't it?

(Testimony of David Watt.)

A. It does, but I didn't know when I made that change that that would be the result.

Q. Now, that change, by the way, was not disclosed in your answer to our interrogatory that requested you to state the basis of all changes that were made in your accounting methods?

A. No, it must have been overlooked. It was so relatively small it must have been overlooked.

Mr. Bennett: I think counsel will concede that the answer to Interrogatory No. 10 did not state that particular change that was made.

Mr. Rosenberg: I don't believe it does.

Q. (By Mr. Bennett): Do you know what that air compressor is used for in your plant?

A. No, I don't. I know it has something to do with the loader and something to do with the vacuum pumps, but——

Q. The major portion of its use in any way is directly involved in the production or manufacture of other products, isn't it?

A. That I don't know. According to the allocation it would be.

Q. Yes, as far as you know, this increased percentage assigned to the air compressor was because of some estimate that had been given to you by someone else in the company, is that correct?

A. Yes, that is correct.

Q. At that time you were actually striving, though, weren't [985] you, Mr. Watt, to see how many items of cost you could add to the gypsum produced for Pacific Portland Cement Company in order to increase the price?

(Testimony of David Watt.)

A. I definitely was not. As I pointed out to you before, you can't tell what products are going to increase when you make a change like that. I was trying to get a better allocation for something I knew was wrong.

Q. So far as you know there wasn't an actual increase in the percentage of use of that air compressor in the second period where you increased the charge for it over the preceding period where the charge was approximately one-quarter?

A. There definitely was to the gypsum department, because the gypsum hadn't had their correct amount previously to that. [986]

Q. Well, no. You misunderstood my question, I think. As far as you know, there wasn't any greater use made of that air compressor in the second comparative period, beginning in '4—I mean in the last comparative period, beginning in 1945 over the preceding period, was there?

A. I still don't understand your question, Mr. Bennett.

Q. Well, as far as you know, the air compressor was used in the same way and to the same degree, its actual use, in 1945-'6, as it was used during the preceding period, isn't that a fact?

A. Yes, I would believe so.

Q. And as it had been used during all the previous years of this contract, isn't that a fact?

A. I would believe so, yes.

Q. And no one told you in the plant—well, withdraw that question.

(Testimony of David Watt.)

Now, you made a reference to sulphuric acid and you stated that up until the last period beginning in June, 1945, you had always charged sulphuric acid to another product. Now, the manufacture of the gypsum, if it was affected at all by the addition of sulphuric acid, had been so affected through all the previous years of its manufacture at this plant, had it not? A. I would believe so.

Q. And the only reason that you made this change—Withdraw that question.

And prior to 1945 you had never assigned this charge against [987] gypsum, either a direct or an indirect charge, of any cost whatsoever for sulphuric acid? A. That is correct.

Q. And you say the only reason you assigned for the first time in 1945 and 1946 that period, the last comparative period, the total cost of the sulphuric acid used in the plant against gypsum was because you had discontinued for the time being the manufacture of the bromine, to which product previously the total charge of sulphuric acid had been made, is that correct?

A. That is correct.

Q. Now, that change in the assignment of the charge had the effect, according to your theory and your basis of accounting, of raising the price of gypsum to Pacific 35 cents a ton, and later, as you reduced that figure, to 22 cents a ton.

A. 23.

Q. It would raise the price of gypsum to Pacific Portland Cement Company 22 cents a ton?

(Testimony of David Watt.)

A. 23 cents a ton.

Q. 23 cents a ton, thank you. I am corrected. Now, you resumed production of bromine again in 1946, didn't you?

A. Some time, yes, uh-huh.

Q. And during—and how long was that bromine produced in 1946?

A. I believe three or four months. I am not quite sure of that.

Q. During that three or four months, during that period of [988] time, you were not charging against bromine any part of the sulphuric acid that always previously you had charged against it?

A. That is true.

Q. And it was only after this suit was filed that you went back and made some charge against bromine produced in 1946 which had been previously assigned by you or charged by you against gypsum, is that correct?

A. That is correct. I found an accounting error and so adjusted it.

Q. And during that period of time you were producing bromine, did you charge against it all of the sulphuric acid used in the plant or merely allocate a certain portion of it?

A. Charged all of the sulphuric acid.

Q. You did? A. Yes.

Q. Are you producing bromine at the plant now?

A. We are not.

Q. When is the last time you produced any bromine there?

A. Back in '46, I believe.

(Testimony of David Watt.)

Q. Well, the best of your recollection is some time in 1946?

A. Some time in 1946, yes, sure.

Q. Now, according to the figures furnished in this document, which is Plaintiff's Exhibit 18, the photostat document, you have an item of engineering expense that is considered as an [989] indirect charge, is it not? A. It is.

Q. What page does that appear on here?

A. Sheet 3.

Mr. Bennett: That is sheet 3, Your Honor, entitled "Overhead and General Plant Expense." I guess we didn't mark those pages, Your Honor. This is the one I am referring to.

The Court: All right.

Q. (By Mr. Bennett): Now, please note the charge that you have for engineering as an indirect charge in 1941. I believe the figures are stated there by you to be \$367.10, which engineering charge was in 1941, and according to my reading of the chart, you show that for the last comparative period, June 30, 1945, to July 1, 1946, a charge allocated to gypsum of \$2,508, or approximately eight times the amount that you charged for engineering under general overhead to gypsum in the last period as compared to the period 1941. Will you explain why that eightfold increase occurred, Mr. Watt?

A. Well, in—our engineering department is much larger now than it was in the early days.

(Testimony of David Watt.)

Q. That was not necessitated at all by the gypsum operation in so far as the production of gypsum for the account of Pacific Portland Cement Company was concerned, was it?

A. I would say it was, a great deal of it.

Q. Well, upon what basis do you make that statement? [990]

A. Because——

Mr. Rosenberg: Just a moment now.

Mr. Bennett: Let the witness answer, please.

The Witness: Is there a question?

Mr. Bennett: Yes.

The Witness: What was the question, please?

(The Reporter read the last question by Mr. Bennett.)

A. The engineering department has as much work to do with the gypsum as any other product or any other department.

Q. What percentage of the engineering department, the total cost of the engineering department, do you assign or seek to assign or charge to the whole of your operation?

A. I don't quite get that.

Q. What is the total engineering department of your plant?

A. You mean in dollars?

Q. Yes.

A. I don't know. I wouldn't know offhand.

Q. Do you know what percentage of that total you charge to gypsum?

A. I do not.

The Court: It is charged on a tonnage basis.

The Witness: Not in this case, Your Honor.

(Testimony of David Watt.)

Mr. Bennett: Your Honor, there are all kinds of basis here.

The Court: Just a minute. Up at the top of the sheet it says "Amount Per Ton," on this sheet that I have got here. [991]

The Witness: That is the unit cost per ton, Your Honor.

Mr. Bennett: But it is not allocated on that basis, though, Judge.

The Witness: It is allocated on a labor basis, Your Honor.

The Court: On what?

The Witness: On a labor basis, Your Honor.

The Court: What do you mean by a labor basis?

The Witness: A direct labor basis.

The Court: Well, that answers it.

Q. (By Mr. Bennett): What I am trying to get out is what the total cost of his engineering department down there at the plant was.

A. I don't carry these figures around in my head, Mr. Bennett.

Q. Do you know the relation of the labor basis on which the charge is shown in Plaintiff's Exhibit 18?

A. I definitely don't know from this sheet here.

Q. Do you know whether it is on a 5 per cent or 10 per cent or 15 per cent basis?

A. I definitely couldn't say on that until I checked the figures.

Mr. Bennett: You know, counsel, don't you?

(Testimony of David Watt.)

Mr. Rosenberg: No, I don't, but I can get that for you.

The Witness: I haven't got these figures in my head.

Q. (By Mr. Bennett): Your own exhibit, Mr. Watt, Exhibit F to your answer to plaintiff's interrogatories, would indicate [992] under item 2 that the amount of overhead allocation was 7.8 per cent to gypsum.

A. That is the answer then, Mr. Bennett.

Q. All right, in other words, all these overhead items appearing on this particular sheet entitled "Overhead and General Plant Expense," were just assigned to gypsum and the figures on that page relate to the basis of assignment of 7.8 per cent of the total cost or charge for those overhead items for the whole plant, is that correct?

A. That is correct.

Q. Now, in determining the allocation of engineering, rather than determining the relative increase or decrease or actual increase or decrease in the amount of engineering services if any applied to gypsum, you simply applied this arbitrary figure of 7.8 per cent which represented the relation of direct labor employed in the drying, grinding and loading of gypsum to your whole Newark plant operation, isn't that correct?

A. You will have to read the question again.

(The Reporter read the last question.)

A. To the whole of the Newark? That was the gypsum portion of it only, yes.

(Testimony of David Watt.)

Q. But you simply applied to gypsum or allocated to gypsum 7.8 per cent of the total cost of your engineering department for this last period; wasn't that the way you did it?

A. That is correct, but it is done on a labor basis. [993]

Q. Yes, and the labor basis you refer to is the total cost of direct labor employed in the gypsum operation, the drying, and grinding and loading of gypsum, as applied to the total labor cost of your operation in the Newark plant.

A. As compared to the total labor cost, that is correct.

Q. And it was on that basis that you signed this charge of \$2,508.03 for engineering for the last period in suit, the last twelve months' period involved in this suit, June 30, 1945, to July 1, 1946, rather than upon any basis of an increase in actual engineering service in the manufacture of gypsum, isn't that so?

A. That I couldn't say. I do not control the engineering services or know anything about them.

Q. As a matter of fact, so far as you know, there hasn't been any more engineering service rendered in the last period than there was rendered in 1941 as far as the gypsum operation is concerned?

A. I definitely cannot say that or even agree to it, Mr. Bennett.

Q. Because you do not know, is that it?

A. I do not know.

Q. You do not know? A. I do not know.

(Testimony of David Watt.)

Mr. Bennett: All right. [994]

Mr. Bennett: Shall I go on, Your Honor?

The Court: Yes.

Q. (By Mr. Bennett): Since you started your operation in production of gypsum in 1937, you have greatly expanded your plant in other particulars, have you not, Mr. Watt?

A. In what particulars? I am not quite sure what you mean by that question, Mr. Bennett.

Q. You have gone into the production of new items and products; you have erected additional plant facilities and in general expanded the scope and extent of your operations, have you not?

A. I would say so, yes.

Q. In the engineering field during the war, you built here, or someone built them for you at the plant, a catalyst plant, is that correct?

A. That was not for Westvaco.

Q. What?

A. That was not for Westvaco.

Q. Wasn't that operated by Westvaco during the war period?

A. No, that was operated by Westvaco as agents for rubber reserve.

Q. In the operation of that plant you had certain new and additional overhead items that had not previously been involved, did you not?

A. No, in the newer plant that was a complete and separate unit on its own. [995]

Q. Isn't it a fact that the plant guards you had

(Testimony of David Watt.)

during the wartime were primarily required for the protection of this particular catalyst plant?

A. No, they were not for that purpose. The guards were on that plant payroll.

Q. Why was it that during the war period you had guards that you did not have at other times?

A. I don't know. You would have to ask the production department.

Q. That was not in any way necessitated by this catalyst plant.

A. No, it was not in any way necessitated by that.

Q. And it was not necessitated in any way by the selling of gypsum to Pacific Portland Cement.

A. I would say certainly it was. Pacific Portland Cement should take a part of it just as anyone else.

Q. Outside of the manufacture for sale to Pacific Portland Cement Company, you were manufacturing products for sale to the federal government or some of its agencies. A. We were.

Q. And as a part of those contracts you were required to furnish plant guards.

A. That I cannot say; that I don't know.

Q. Wasn't that really the reason you put on the plant guards during the wartime to comply with requirements you had in [996] contracts with the federal government to protect your operations in so far as the federal government was concerned, a protection entirely apart from the gypsum that you were selling Pacific Portland Cement Company.

(Testimony of David Watt.)

A. I cannot answer that because I don't know.

Q. You don't know? A. I don't know.

Mr. Bennett: Does Your Honor wish to go on at this time?

The Court: I am trying to get through with this case. That is the reason I am running later than usual tonight. I would not want the record to show I am being imposed on in this case. But it is bordering on that, gentlemen, if I have any conception of my duty. I say that without reservation.

Let us proceed. I am going to get through with this case. There is no reason why this Court should be turned over to a bookkeeping process, and after experts, able to represent both sides, testify, and to have me determine and sit in judgment on them with the presentation of this case in the fashion it has been presented, I am free to say that there is a situation engaged in here that does not belong here.

Mr. Bennett: I don't know but I am going to agree with Your Honor perhaps to this extent, that in view of the period of time, and I am conscious of that, that this case has taken, and knowing Your Honor's attempting, as presiding judge, to expeditiously handle a tremendous load of litigation, that at least, [997] comparatively, a long period of time has already been spent in this case. It might have been better, if Your Honor please, in the light of those considerations to have had what Your Honor has perhaps done before, a reference to a master. As Your Honor recalled, we

(Testimony of David Watt.)

tried to arbitrate this matter from the beginning and the other side would not agree.

It is true that this case involves a great deal of detail and accounting, but, however, as Your Honor told us Wednesday noon, this goes somewhat to the essence of this case. This is an unusual case. It is not the type of case that ordinarily comes before the Court, but it is one of those matters that has arisen in our life and the lives of these two business concerns involving an important contract. I cannot claim that merely because it is important that it requires any undue allocation of time by the Court, but I don't know how in view of the issues involved and the necessary facts upon which the Court may base an advised opinion when the case is through, it would have been possible for us to proceed other than we have attempted to do.

The Court: I fully appreciate your difficulties, but I did not bring your difficulties in here. I can understand those things. I have seen so much of this that I am not taken by surprise at anything that may occur here in court.

Mr. Bennett: I hope Your Honor will indulge us, and I say this for my brother counsel as well as myself that we are [998] both trying to get through. I may be more inept in presenting facts as I see them, but after all, both sides have given a great deal of time and study to this case and we are both endeavoring to bring the matter so the Court will have all the facts that will have a bear-

(Testimony of David Watt.)

ing on the theory of both sides which are not usual or simple.

The Court: I realize that, and that is the reason why I have given you generously of my time.

Mr. Bennett: I hesitate to take time in cross examining a witness if the Court feels such cross-examination is wholly beyond the point of the case the Court is interested in, or that I am proceeding in a method that is not consistent with the Court's desire.

The Court: My desires should be eliminated from the case.

Mr. Bennett: After all, you are the most important in this whole case because you have to decide it.

The Court: To be perfectly frank, and if I may comfort you or disappoint you, here is a case where both sides can take care of themselves in relation to their contract, in relation to their bookkeeping methods and I can understand how these difficulties arise. But it is beyond me to go into these items in the fashion we have been going into them and wasting the time you have. You can answer that by saying it is an unusual situation and it is a difficult situation and I realize that. [999]

That is the reason I gave you, as I have said, generously of my time here. But after all, there is nothing at all very mysterious about this case any more than any other case.

Mr. Bennett: Oh, no, I did not mean to infer there was anything mysterious about this case. I

(Testimony of David Watt.)

think it is a very justicable controversy and the Court can do the best it can with it.

The Court: I do the best I can under all difficulties here. Those things do not exercise me very much. I have no difficulty in finally determining these matters. I always invite counsel to protect the record so that in the event they are disappointed by me, they may have the record reviewed.

(Discussion between Court and counsel.)

The Court: We will adjourn this case until Tuesday morning, December 30, at 10:00 o'clock.

(Whereupon an adjournment was taken until Tuesday, December 30, 1947, at 10:00 o'clock a.m.)

Tuesday, December 30, 1947, 10:00 o'clock a.m.

The Clerk: Pacific Portland Cement Company vs. Westvaco Chlorine Products Company.

The Court: You may proceed, gentlemen.

DAVID WATT,
recalled.

Cross-Examination
(Resumed)

By Mr. Bennett:

Q. Mr. Watt, we have used during your examination as well as the examination of other witnesses, the terms "Direct charges" and "Indirect charges." So that we may have a complete understanding of what in your testimony you refer to as direct charges and what you refer to as indirect charges, I ask that you refer to Plaintiff's Exhibit 18. On

(Testimony of David Watt.)

the first page, under the title "Westvaco charges per book for cost of production to gypsum—Summary," you have listed direct charges; those direct charges that are in that summary refer to the direct charges listed under that title on the second page of this exhibit, do they not?

A. Well, these items were listed by the Pacific Portland as direct charges. In addition to these, I say that bittern is also a direct charge.

Q. All right, but let's get the record straight: Now, all of these items that are listed on page 2 of Plaintiff's Exhibit 18 under the title "Direct charges," namely, "Payroll, increase [1001] reserve, labor operations, labor repairs, workmen's compensation insurance, social security, taxes, materials and supplies operations, materials and supplies repairs, water power, gas, fuel oil," are considered by you and are referred to in your testimony now and hereafter as direct charges?

A. They are.

Q. Written in on this same page in this writing apparently are the words "Truck and tractor," and under that "Miscellaneous," you inserted those words, "truck and tractor"—

A. We did.

Q. (Continuing): ————didn't you, after you got this form from Mr. Flick?

A. We did.

Q. You consider that item "truck and tractor" as appears under the title page "Direct charges" as a direct charge?

A. We do.

Q. Will you explain just what that item is, Mr. Watt?

(Testimony of David Watt.)

A. The "Truck and tractor" item is the cleaning up—use of trucks and tractor in cleaning up around the gypsum plant.

Q. You only have a charge for that item for the period July 1, 1945, to June 30, 1946, is that correct?

A. Yes, that's correct—no, 1944 to 1945.

Q. No, we are both wrong. The only period from 1937 to June 30, 1946, where there is a charge for truck and tractor as a direct charge, is in the year July 1, 1944, to June 30, 1945, is that correct? [1002]

A. That's correct.

Q. There was some special situation that year, was there, which required the use of this tractor?

A. I would say so, yes.

Q. But you don't know of your own knowledge of that; you just assume that?

A. I just assume that, yes.

Q. Now, the "Miscellaneous" you have listed here in your own handwriting is also a direct charge and shows a charge only for the last year in question, namely, July 1, 1945, to June 30, 1946. Will you explain just what you mean or meant by the term "Miscellaneous"?

A. Well, by "Miscellaneous," here, is meant—you could not really apply it to "Material and supplies operations and repairs"—it was a miscellaneous charge.

Q. But a direct charge?

A. A direct charge to gypsum, yes.

(Testimony of David Watt.)

Q. It was not one of these so-called overhead or indirect charges that you simply allocated a portion——

A. No.

Q. But it was a direct charge that went into the manufacture of this gypsum?

A. That's right.

Q. But you don't recall just what it was?

A. I don't recall just what it was. [1003]

Q. All right. You say you also considered in addition to these items that appear on the second page of Plaintiff's Exhibit 18 under the title "Direct charges" that there are also other charges listed on that exhibit which you also consider direct charges for the manufacture or production of gypsum.

A. Yes, bittern to me is a direct charge.

Q. You consider that and you refer to that as a direct charge?

A. Yes.

Q. Now, what other items, if any?

A. "Supervision" is a direct charge.

The Court: Pardon me, was that "bittern"?

A. Bittern.

Mr. Bennett: Bittern.

The Court: That is the first time during the course of this trial that bittern has been mentioned in relation to charges.

Mr. Bennett: No, it has been mentioned several times.

The Court: It has been mentioned, yes, but not in relation to charges.

Mr. Bennett: The testimony of this witness

(Testimony of David Watt.)

shows they are making an arbitrary charge for bittern against the cost of gypsum.

Q. (By the Court): Break down that charge; give me more information about it, please. Is it disclosed there on that exhibit?

A. No, it is not. [1004]

Q. (By the Court): It is an arbitrary charge?

A. It is an arbitrary charge. The basis for charging bittern to the production at Newark is an arbitrary charge.

The Court: I understand that, but what is it based on? Is it just an arbitrary charge?

A. That is all we can say, your Honor, is that it is just an arbitrary charge.

The Court: All right.

Q. (By Mr. Bennett): Other than bittern, what other items on the summary or in this whole exhibit do you consider additional items of direct charge?

A. "Bittern, sulphuric acid, supervision."

Q. Now, you have considered and referred to "supervision" in your testimony heretofore as a direct charge. Where does that appear on this exhibit breakdown, Mr. Watt? That appears on the next to last page under the title "Bittern, insurance, taxes, depreciation, interdepartmental water, sulphuric acid and supervision." Now, just what is this item of "supervision" which appears on the calendar years July 1, 1944, to June 30, 1945, and the succeeding or last period, July 1, 1945, to June 30, 1946?

(Testimony of David Watt.)

A. The portion of the plant supervisors allocated to gypsum.

Q. Do you mean by that there is a plant supervisor and you allocate a portion of his salary to the gypsum operations?

A. Not one supervisor—all supervisors. We have a supervisor [1005] on every shift.

Q. You mean for your whole plant operation?

A. For our whole plant operation.

Q. They supervise the manufacture of these 40 separate products that are being manufactured?

A. Yes, including the gypsum.

Q. You take all of those supervisors and from their total salaries and wages you allocated certain portions to the cost of gypsum?

A. That is correct.

Q. The first time you attempted to do that was this period July 1, 1944, to June 30, 1945, is that correct?

A. That's correct.

Q. Prior to that time you did not allocate any part of this?

A. Prior to that time it was included in "overhead"—included as an indirect charge.

Q. Well, now, on what basis do you make this allocation of "supervision"?

A. It is allocated on an operating labor basis.

Q. It is allocated on an operating labor basis?

A. Yes.

Q. You mean the relation that the direct labor employed in the gypsum processing, the drying and grinding and shipping of gypsum bears to the di-

(Testimony of David Watt.)

rect labor involved in the manufacturing of these other 39 products? [1006]

A. That's correct.

Q. You don't keep a detailed breakdown by any time charts or time sheets showing the precise percentage of time these supervisors devoted to gypsum, do you? A. No, we don't.

Q. This, again, is what might be called the arbitrary allocation on the basis of labor?

A. That's correct. I might add it would be impossible for a supervisor in a plant like ours to keep records of this type.

Q. I daresay that would be true where you manufacture 40 products down there, as you testified. However, outside of those items that we have mentioned all of the other items of claimed charges or cost would be classed or considered under the category of indirect costs or charges, would they not?

A. That's correct, except shipping expense.

Q. The shipping expense you have listed in this exhibit involves both direct charge and a claimed indirect charge, isn't that correct?

A. That's correct.

Q. The direct labor involved in the shipping, that is, the handling of the gypsum after it is dried out and ground, pumping it into this big pump from the warehouse into the cars, and the direct labor involved in connection with handling the gypsum is listed as a direct charge?

A. Yes. [1007]

(Testimony of David Watt.)

Q. We went into that the other day.

A. Yes, you went into that the other day.

Q. Then you have assigned approximately a similar amount for charges that you say are allocated now on a tonnage basis which were formerly allocated on a value basis for general supervision in that shipping department, the supervisor and assistant, and so forth—all of those charges are called by you or classed by you as indirect charges?

A. Yes—miscellaneous shipping.

Q. Mr. Watt, these items of direct charges that appear separately under the title of direct charges on the second page of plaintiff's exhibit 18 are charges and costs that would not go on or exist if the production of gypsum were stopped or were not continued; that is a fact, isn't it?

Mr. Rosenberg: Which page are you on?

Mr. Bennett: The second page.

The Witness: Direct charges.

Mr. Bennett: Was there an answer to the question?

The Reporter: The witness said, "Direct charges."

Q. (By Mr. Bennett): Those charges and items listed under the title "Direct charges" on the second page of Plaintiff's Exhibit 18, beginning with "Payroll, increased reserve, labor operations, labor repairs" and so forth are charges, of course, which would not be incurred except for this manufacture of gypsum, isn't that correct? [1008]

A. That's correct.

(Testimony of David Watt.)

Q. (By the Court): What relation has the amount per ton to these figures?

A. This amount here?

Q. No, right here on top.

A. Your per ton figures are these various amounts divided by the number of tons.

The Court: That is what I thought. I wanted to be sure.

Q. (By Mr. Bennett): Now, I am passing over to the other page, where you have listed this item of "Supervision" which you first set up——

The Court: On the same page?

Mr. Bennett: No, your Honor, it is a latter page.

The Witness: It is the fourth page.

Q. (By Mr. Bennett): You state that this item of "Supervision" that you first set up as such an item of 1944-1945, is considered by you a direct charge, even though it is an allocated charge, is a portion of the general cost of supervision of manufacture of all of your 40 products: It is a fact, is it, Mr. Watt, that if gypsum were not produced there, that is, if there were no gypsum production, that cost of supervision, that is the total cost from which you have allocated this portion that appears on that page of Exhibit 18 would go on, nevertheless, would it not? A. It would. [1009]

Q. And in that sense it differs from these other direct charges and costs which would not exist if gypsum were not produced?

(Testimony of David Watt.)

A. That's correct.

Mr. Bennett: I might say at this juncture, your Honor, if I am not intruding on your Honor's present thought, that the court probably, in view of the maize or mass of figures involved in this case, will want this matter briefed when it is finally submitted, and especially we are going to try and speed up the cross-examination of this witness, and I did not intend to go into separate detail as to all of these matters. Obviously, if the court desires that, I would be very happy to do it, but I thought that covering the phases of the case as we best can with limited time we can probably be of aid to the court in analyzing these figures under our respective theories in such a way as will not involve a burden on the court in minutely examining the documents in the various details.

The Court: Is that agreeable, Counsel?

Mr. Rosenberg: That is agreeable.

The Court: Very well.

Mr. Bennett: It seems to me that is an efficient way to handle this and to be of aid to the court, and perhaps enable us to save time.

The Court: All right.

Q. (By Mr. Bennett): Now, Mr. Watt, the same thing as occurs in the case of this supervision item which you say the cost [1010] would go on whether or not gypsum was produced applies to all the indirect items, isn't that correct?

A. I would say so, yes, but at the same time if we did not stop production of gypsum it would be

(Testimony of David Watt.)

hard to say if we could lay off an engineer. It is impossible to say that.

Q. In other words, if you were to shut down your gypsum manufacture, just lock up this place where the gypsum is dried and ground and delivered, and stop the manufacture of gypsum, all these indirect items that you have allocated a portion to gypsum would go on and continue as costs and expenses of your plant, notwithstanding, wouldn't they? A. They would.

Q. And the same thing would happen as to this bittern, wouldn't it, Mr. Watt?

A. No, I don't believe so. If we stopped the gypsum department I believe we would not require as much bittern. [1011]

Q. As long as you make magnesium oxide and these 39 other products, you have to use bittern for that purpose?

Mr. Rosenberg: I object to the question as assuming a fact not in evidence. You are talking about magnesium oxide and 39 other products.

Mr. Bennett: I am sorry. I withdraw it.

Mr. Rosenberg: No. I want to finish my statement. You are trying to get something in here, squeeze it in. I want to make it.

Mr. Bennett: No.

Mr. Rosenberg: I object to the language you used, magnesium oxide and 39 other products. It is not magnesium oxide and 39 other products. It is a variation——

(Testimony of David Watt.)

The Court: Am I correct that all direct charges in this examination are explained in this——

Mr. Bennett: Your Honor recalls he says it is an arbitrary charge to bittern. We don't know, Your Honor does not know, and I don't know how that arbitrary charge is made. We consider it improper on any such basis or at all. The witness has stated to Your Honor that he considered it a direct charge and I wanted to find out from the witness if he knows or has an opinion on it.

The Court: Can you explain this item (indicating to witness)?

The Witness: Bittern, Your Honor, here, \$5794.88 or 16 [1012] cents and here, \$5854, 18 cents. In this period it actually showed a decrease and all the way through, the amount of bittern and the unit cost per ton.

The Court: That item of \$5,000.

The Witness: \$5794.88.

The Court: So it is an arbitrary charge. Why isn't it \$15,000 if it is an arbitrary charge?

The Witness: Because that would be charging too much to gypsum.

The Court: That is what I tried to develop here, it would be charging too much to bittern.

The Witness: This is way back to 1937, Your Honor; when they started off there was so much per ton for each product we made. It was 20 cents to gypsum and \$35 to dibromine, and 20 cents to gypsum and \$35 per ton to dibromine, and 55 cents to magnesia. These were arbitrary in the first place

(Testimony of David Watt.)

and they have gone on arbitrarily ever since, still on the same basis.

The Court: That is what I had in mind.

The Witness: I might add that gypsum is the product that gets the smallest charge for the bittern.

Q. (By Mr. Bennett): But in the meanwhile, you just considered this arbitrary allocation that you have mentioned? A. Correct.

Q. You have just carried that along?

A. Just carried that along. [1013]

Q. And you have the cents per ton allocated for bittern?

A. The gypsum changed when the bromine towers closed.

Q. When you stopped bromine operation you arbitrarily added a certain amount of the charge to gypsum?

A. The amount of bittern that went to bromine production was allocated equally on a percentage basis between magnesia and the others.

Q. After you stopped making bromine, manufacturing bromine——

A. It meant an increase per ton actually being allocated to the others and magnesia took most of it.

Q. Magnesia took most?

A. That is correct.

Q. Why did you give magnesia most of the cost of bittern?

A. As I said before, originally gypsum was 20 cents per ton, bromine \$35 a ton, magnesium to 55

(Testimony of David Watt.)

or 60 cents per ton. When we prorated the portion that went to gypsum, naturally the magnesium which was being charged at 55 cents would take a greater portion bearing on the charge for bittern.

Q. As a matter of fact, back in the period July 1, 1939, to June 30, 1940, that is one period and the charge for bittern was 10 cents and the next annual period, July 1, 1940, to June 30, 1941, you had a charge against bittern of 14 cents per ton.

A. That is so.

Q. Yet in the second period you produced a larger tonnage of gypsum than the first period. Do you know why that increase of [1014] 4 cents per ton?

A. I would say the pumping costs on bittern were higher than the relative ratios in the charges for maintenance.

Q. You mean that all through the years you have assessed against gypsum 20 cents—

A. The first year started at 10 cents, if I am right; I think it started at 10 cents rather than 20; for 1942 and '43 it increased to 20 cents.

Q. How many more times of the bittern expense today is charged against the magnesium rather than against gypsum; can you tell us that?

A. I believe there is a letter that Mr. Flick has there.

Q. Well, don't you know?

A. No. I would like to get the correct figures from that letter. Mr. Seaton gave you a letter, Mr.

(Testimony of David Watt.)

Flick, while you were at Newark once, showing the change in the allocation of bittern to gypsum.

Mr. Flick: I don't recall any letter.

Mr. Bennett: Let me see if we can get it this way.

Q. Is gypsum charged 5 per cent of the total cost of bittern?

A. That I couldn't give you until I see the figures.

Q. You don't know whether 5, 10 or 2 per cent?

A. No. I think it is more than that.

Q. Among these indirect charges which you say would go on whether or not gypsum was produced, appears the item of [1015] purchases and stores. Your Honor will find that on the second page of this exhibit. I don't think it is necessary to refer that to the Court. There is an item of purchases and stores. Note that the cost per ton of that indirect allocated item has increased since 1941 approximately six times.

The Court: Can you explain that?

A. Yes, I can, Your Honor.

The Court: Explain it.

A. In 1941 when things began to get so tough we had to increase our departments and get priorities and governmental reports and things like that and it nearly doubled our force in the personnel department and increased salaries.

Q. (By Mr. Bennett): In 1942 and during the war salaries were frozen at the same level.

(Testimony of David Watt.)

A. True, but I mean when you hire somebody new there was no freeze on his salary. You could pay him what you wanted.

Q. During the period from 1943 your plant has greatly expanded in all particulars than the manufacture of gypsum, has it not?

A. What particulars?

Q. Well, in the manufacture or development of these other 39 products that you produce down there.

A. I question it is so. I don't know. In what way?

Q. Haven't you developed new products and started new products during that period of time?

A. We have. [1016]

Q. A good portion of this particular item of overhead has been, in so far as it is increased is concerned, due to these other operations rather than the gypsum operation?

A. No, I don't agree with you at all on that.

Q. Mr. Watt, you produced in the period as early as 1940-'41 nearly as much gypsum as you produced in the last year shown here, 1945.

A. In 1941, 32,000 and up to around 36,000.

Q. During that time you say your purchases and stores, there was a rise of six times in that item in so far as the charge to gypsum is concerned. That has not been due to anything directly involved in the manufacture of gypsum?

A. It certainly has. It is as difficult to buy valves

(Testimony of David Watt.)

or piping or any supplies for the gypsum department as any other department in the plant.

Q. You mean each item of increase is directly proportioned to the cost of the gypsum department?

A. I do not understand that question.

Q. I understood you referred to this item of purchases and stores as an indirect item—that is one of the allocated items? A. It is.

Q. You allocated on some arbitrary basis of the relation to labor? A. That is correct.

Mr. Rosenberg: I object to that. The witness said [1017] overhead expense is allocated on a basis of what the labor in your gypsum department bears to the labor in the entire plant. Counsel repeatedly makes reference to the fact that that is an arbitrary——

Mr. Bennett: We contend it is, and I think accountants will contend it is. Merely because you don't like it——

Mr. Rosenberg: No, it is not. I object to this form of cross-examination.

The Court: I know the position of both sides. I understand that. I understand the theory of both sides on that, but I think we are wasting time if we continue on this line of testimony unless there is some particular thing.

Mr. Bennett: I will close in just a minute. Your Honor recalls this witness said that from these indirect items there were allotted, there was an increase of six times, so that actually the purchases and stores function that had anything to do with

(Testimony of David Watt.)

supervising the purchasing of materials and repairs for the gypsum department actually increased six times.

The Witness: I don't recall ever saying it. It bears the same relation to gypsum now as it did in the earlier days so, therefore, it did increase on gypsum.

Q. (Mr. Bennett): The actual cost of materials, valves and materials used in the gypsum plant are provided for in another part of your charge sheet, aren't they? A. Correct. [1018]

Q. Under direct charges?

A. Direct charges.

Q. This item in the purchases and stores merely has to do with the so-called overhead of the purchases and stores? A. Yes.

Q. In your plant at the time?

A. That is what it is, yes.

Q. Do you mean to say to this Court that the actual cost of—the time records were kept for the gypsum phase of that purchases and stores department, that it has increased six times since 1941?

A. I certainly would say it has increased six times since that date.

Q. Do you have any records or documents or evidence to support your statement?

A. Well,—

Mr. Rosenberg: Just a minute.

The Witness: I don't see how the fact—

Mr. Rosenberg: Just a moment.

Mr. Bennett: I am cross-examining the witness.

(Testimony of David Watt.)

The Court: One of the difficulties here is taking supervision, for example. There is no doubt that they don't keep books on just——

Mr. Bennett: I know that, Your Honor. I want to show, as I think the fact is, that where in 1941 they had the same [1019] amount of production and the actual cost, the actual stores that went to the gypsum plant are reflected elsewhere, not involved in this item at all, and it is absurd to contend that the actual gypsum part of this overhead went up six times or sixfold. The witness says it does and the thing I am directing to his attention—the witness can't prove that to be a fact.

The Court: Can you explain that?

The Witness: What the counsel is asking me is how many valves or how many pieces of pipe, how many different things we purchased for the gypsum plant and how much actual time the purchases and stores put into that. One specific kind of valve might take three days to purchase for the gypsum plant, but we don't keep time allocated on that. It is absolutely impossible. He is talking about the difference between 1941 and 1946. As I explained, in 1941 we had an increase which about doubled our purchasing department.

Mr. Rosenberg: Now, you were asked the question if you kept accurate time records, would it be six times. If we had accurate time records you would not allocate? A. No.

Q. The reason you allocate there is because you can't keep accurate time records so you must allocate it among the various products.

(Testimony of David Watt.)

A. That is true.

The Court: It is time to take a recess.

(Recess.) [1020]

The Court: You may proceed.

Q. (Mr. Bennett): Now, Mr. Watt, it is a fact, isn't it, that if other activities in your plant down at Newark in the manufacture of any of these other 39 products required a greater overhead and indirect plant charge or charges for these indirect items that under your system of allocating a portion of the overhead to gypsum would result in the gypsum being charged with an increase in such overhead; that is a fact, isn't it?

A. I don't get your question. Will you please read it again?

Q. Well, let us assume that the operations at your Newark plant in the production of products other than gypsum required or resulted in a greatly increased overhead and indirect charge of operation down there, one or all of the so-called indirect items that are listed in Plaintiff's Exhibit 18, by this method of allocating a portion of that increase of charges to gypsum necessarily resulted in an increase in the indirect charges allocated to gypsum; that follows, doesn't it?

A. No, I don't think you could assume that, at all. All of these overhead departments are for the whole of the plant.

Q. I know that. That is what you would call the so-called overhead burden, isn't it?

A. That is correct.

(Testimony of David Watt.)

Q. But supposing by reason of new products that you had developed, new methods of packaging or selling these products other than gypsum, your overhead had gone up five or six times over what it was in any previous period; this method that you found of allocating those charges would also impose an increase in the indirect charges allocated to gypsum, wouldn't it?

A. I don't think you could assume that, because it is not a fact.

Q. I am asking you to assume it, Mr. Watt.

A. I don't see how I could assume that.

Mr. Rosenberg: I object to that as pure conjecture.

Mr. Bennett: This is cross-examination, and I think the purpose is quite evident. If your Honor is not interested in that it may be a matter that perhaps is for argument. I won't press it with this witness, but I think it perfectly obvious that if plant overhead that may be caused or results from something having to do with any one of these 39 other products, or all of them together, and not due to gypsum, but nevertheless under this system of allocation on this direct labor basis or any other basis arbitrarily increases the so-called overhead charge made against gypsum.

Mr. Rosenberg: You are getting into the realm of pure conjecture and speculation, and there is no foundation.

Mr. Bennett: Of course, that is our position why

(Testimony of David Watt.)

these indirect charges should not be allocated in the first place, in that they involve pure conjecture.

Mr. Rosenberg: You are bringing the pure conjecture into this.

Mr. Bennett: I will try to finish as quickly as I can with [1022] this witness, your Honor.

Q. I want to ask you about all these allocated items on page 2 of this Plaintiff's Exhibit 18 which are listed as West Coast Items and starts in with:

“West Coast General Expense—West Coast General Supervision—West Coast Telephone and Telegraph—West Coast New York Office—West Coast Exploration—West Coast Subscriptions and Donations—West Coast Production Coast Control—West Coast Personnel Department—West Coast Group Insurance.”

Now, I notice from my computation of the exhibit that in the calendar year 1942 all of those items grouped together involve a charge of 10 cents per ton against gypsum as you allocated it according to your claim, and in the last period, July 1, 1945, to June 30, 1946, those items were increased to 19 cents per ton. I understood on your direct examination you to say that you at the Newark plant made these allocations other than that they were made either by West Coast headquarters or New York. Will you explain to the court how you at Newark allocated these West Coast claimed expenses that are listed in this exhibit?

A. These are all overhead accounts and are al-

(Testimony of David Watt.)

located to all products on an operating and repair labor basis.

Q. Did the New York office or West Coast headquarters allocate to the Newark plant a certain sum or charge for these various [1023] items that are listed here, such as "West Coast Exploration—West Coast Subscriptions and Donations"?—

A. No, these are actual costs at Newark.

Q. What?

A. These are actual costs at Newark.

Q. You mean at Newark you accept the record of the actual subscriptions and donations that that plant made?

A. We certainly do.

Q. Why do you list them under "West Coast"?

A. I don't know. We don't list them so. This is listed by you as "West coast." These are not the names we carry those under.

Q. What do you mean by or what is your understanding of the figures you have given here under "West Coast subscriptions and donations"?

A. These are subscriptions and donations paid by the Newark office.

Q. Paid out by the Newark office?

A. Paid out by the Newark office.

Q. And you have allocated a portion of those subscriptions and donations to the cost of manufacturing gypsum?

A. Absolutely, as an overhead expense.

Q. What was your understanding of "West Coast General Expense" as it appears in this

(Testimony of David Watt.)

particular sheet, "Overhead and General Plant Expense"?

A. General expense incurred at Newark. [1024]

Q. Wholly unrelated to any other West Coast operation of your company?

A. How do you mean "unrelated"?

Q. I mean, does it involve solely the expense that was incurred at Newark, or is it an allocation of a portion of expense?

A. No, expense incurred in Newark for the Newark plant.

Q. It is not an allocated portion of the West Coast expense?

A. No, but I don't know what you mean by this "West Coast."

Q. As a matter of fact, in 1944, when Mr. Flick went down to see Mr. Cuneo, your superior, these titles were the titles carried on your books at that time—"West Coast General Expense"?

A. I certainly don't think so, because very seldom do we ever use the term "West Coast," and I know we never use "New York" the same as "New York" you have here. It might have been explained to Mr. Flick like that, but I don't remember where we ever had it on our books like that.

Q. Were you there when Mr. Cuneo explained to Mr. Flick how these accounts were set up?

A. No, I was not present.

Q. I beg your pardon?

A. No, I was not present.

Q. Take the title, "West Coast New York Office,"—what does that mean?

(Testimony of David Watt.)

A. That is the portion of the New York office expense that is [1025] transferred to West Coast.

Q. The New York office assigns to the West Coast a certain portion of its overhead, is that right?

A. A certain portion of its cost, I would say.

Q. The cost of running the New York office?

A. I would believe so, yes.

Q. Do you allocate that West Coast portion partly to the Newark plant and partly to the Chula Vista plant and partly to the Hollister plant?

A. That is correct, we do.

Q. That is done in your office?

A. That is done in our office.

Q. In other words, you allocate these New York administrative expenses——

A. We do.

Q. (Continuing): ——among the several plants of your company on the West Coast?

A. We do.

Q. And you allocated a portion of that West Coast total to the Newark plant?

A. We do.

Q. And you took a portion of that and allocated it to gypsum, is that correct?

A. Yes, that is correct.

Q. This item of "West Coast exploration," what is that, Mr. Watt? [1026]

A. West Coast exploration of mining and new mines.

Q. You mean mines down there in your plant at Newark, or mines somewhere else?

A. Mines anywhere on the coast.

(Testimony of David Watt.)

Q. Was that allocated to the West Coast operations by New York? A. No, it was not.

Q. That was an item that you allocated among the several plants of the West Coast operations of Westvaco, is that correct? A. That is correct.

Q. And yet you took and allocated a portion of the Newark plant's share of that West Coast exploration to the cost of producing gypsum, did you?

A. As an overhead, yes.

Q. Will you explain to me what in the world that exploration of mines elsewhere in the country can have to do with the production and manufacture of gypsum down here at this plant that is made out of bittern?

A. Certainly it is part of the plant burden at Newark and all products at Newark, and that should take a portion of it.

Q. And it is on that theory and basis that you set up this cost allocation of charges against the manufacture of gypsum, is it?

A. I don't understand that question.

Mr. Bennett: Will you read the question?

(Question read.) [1027]

The Witness: Will you read that again?

(Question read.)

A. I would say that for spreading the burden, spreading overhead, definitely that is the theory to spread it to all products in any given plant.

Q. You think there should be therefore made as a charge of the manufacture of gypsum sold to the Pacific Portland Cement Company that is made

(Testimony of David Watt.)

out of this bittern water, a portion of the charge that your company has for conducting mining explorations up in the mountains to add to the cost of manufacturing gypsum? A. I do.

Q. And you consider that is good accounting practice for by-products?

A. I certainly do.

Q. And you would say the same thing about the subscriptions and donations that you make down there?

A. I would say the same thing about all of these items.

Q. All of them? A. All of them.

Q. In other words, the same theory in your opinion would apply to the allocation of all of these indirect items?

A. All of the indirect items, yes.

Mr. Bennett: That's all, your Honor.

Redirect Examination

Q. (Mr. Rosenberg): Now, Mr. Watt, you testified that Mr. [1028] Cuneo was out here in 1945 and it was at his direction that you changed back your method of allocating general overhead. Do you recall that? A. Yes.

Q. In the course of conversation with Mr. Cuneo did he give you any instructions regarding allocation of indirect expenses in the shipping department? A. He did not.

Q. With reference to the bagging of the gypsum at Westvaco that the company retains for pharmaceutical, chemical and other purposes, that

(Testimony of David Watt.)

gypsum is bagged, is it? A. Yes.

Q. What size bags are used?

A. I believe they are 100-pound bags.

Q. Is any of the cost of packing that gypsum included in shipping expense?

A. No, it is not.

Q. So that Pacific Portland pays no part of that bagging operation? A. Absolutely not.

Q. With reference to the labor in the shipping department, are time card records kept of the direct labor employed in shipping magnesia on the one hand and gypsum on the other?

A. Direct labor, yes.

Q. So that would you say that any difficulties encountered in [1029] handling magnesia by reason of the fact that a portion of it is packaged, would that come within the direct labor in handling of that magnesia? A. It does.

Q. And would be charged directly to——

A. And would be charged directly to each product.

Q. There was some reference made to the fact that certain portions of the plant have been expanded since the time that this contract was entered into. Can you tell me whether there has been any expansion or enlargement of the gypsum plant?

A. There certainly has.

Q. Do you have a record of the extensions or enlargements made to the gypsum plant?

A. I believe it is attached to the answer to the interrogatories, isn't it?

(Testimony of David Watt.)

Mr. Bennett: It is Exhibit D, as I understand your inquiry.

Q. (Mr. Rosenberg): Referring your attention to Exhibit D, will you just enumerate the additions that have been made to the gypsum plant?

A. In June of 1944 an extension of the gypsum pumping system; in March, 1945, a new gypsum loading hose.

Mr. Bennett: Why not give the figures to save time, so I won't have to go into that, Counsel?

The Court: Give the figures.

A. Extension of the gypsum pumping system in June of 1942, [1030] \$661.54: New gypsum loading hose in March of 1945, \$173.38: Cyclone—gypsum drier, June, 1945, \$5328.62: Heater for the gypsum filter, December, 1945, \$270.15: Air cleaner—gypsum vacuum pump, December, 1945, \$330.07: Dry divider—gypsum drier, February, 1946, \$666.90: Carloading equipment, May, 1946, \$4989.96: Gypsum double panel mixer, September, 1946, \$1961.46: Total, \$14,381.38.

Q. In connection with the allocation of overhead, I believe you stated the overhead charged to gypsum is made on the basis that the direct labor in the gypsum plant there to the direct labor in the entire plant, is that correct?

A. That's correct.

Q. Also in the course of examination I asked you to explain why there appears to be a charge of 1 cent for fuel oil in the period from July 1, 1945, to June 30, 1946, and no charge in the preceding 12-

(Testimony of David Watt.)

month period, and you stated that you could assume why that was, but you had no accurate information. Since the time of that testimony have you made a check?

A. I did check and found that the gas was cut off at that time and we had to go over to fuel oil.

Mr. Bennett: We are not disputing that charge. It is not a matter in issue in this case, at all.

Q. (Mr. Rosenberg): With reference to these overhead charges, Mr. Watt, you were asked whether or not if we discontinued the production of gypsum those charges would continue anyway. [1031] Let me ask you, if we discontinued the production of magnesia and continued the production of gypsum would the same thing apply?

A. Definitely it would.

Q. In that event, would those indirect charges or overhead expenses continue, notwithstanding the discontinuance of the production of magnesia?

A. It would.

Q. Directing your attention to the summary sheet of Exhibit 18, and calling your attention to the fact that the bittern charge from July 1, 1944, to June 30, 1945, was 18 cents, and is only 16 cents in the same period, or a reduction of 2 cents per ton, can you explain how that reduction occurred?

A. The reduction in the second period is actually due to the fact that the higher cost of bittern was charged to magnesium products.

Q. You have stated that at the inception of these operations you determined a certain amount

(Testimony of David Watt.)

to charge to gypsum for bittern, and to bromine for bittern, and to magnesia for bittern, is that correce? A. That is correct.

Q. Throughout the years during the time that this contract has been in effect, and during the period that those products were being made at the Newark plant has the relative percentage of bittern charged to those three products been constant? [1032] A. It has.

Mr. Bennett: It seems to me that is contradictory to the last statement the witness made, Counsel. [1032-a]

Q. Directing your attention again to Exhibit 18, the page entitled, "Shipping Expense," to this figure of \$4859.99, that is the aggregate figure for the so-called allocated expense. Is there any question as to the accuracy of that figure?

Mr. Bennett: What figure is that?

Mr. Rosenberg: That is the figure you were calling for for the amount, the total of the allocated——

Mr. Bennett: I think that his answer would call for a conclusion and it is not proper redirect examination. The witness has already been examined both by you and by me with reference to that.

Mr. Rosenberg: I beg your pardon. I will challenge you to show any word of the transcript where I asked him about that figure.

Mr. Bennett: You asked him about all the figures in that sheet.

Mr. Rosenberg: No, I did not.

(Testimony of David Watt.)

The Court: He may answer. Let's get through.

A. (The Witness): There is no question about the correctness of it.

Mr. Rosenberg: That is all.

The Court: Is that all, counsel?

Mr. Rosenberg: Yes, Your Honor.

The Court: Step down.

Mr. Bennett: Your Honor does not want any more? [1033]

The Court: Proceed.

Recross-Examination

Q. (Mr. Bennett): You don't mean to say, Mr. Watt, that if you shut down manufacture of 39 other magnesium products and products of selling value of \$35 to \$80 a ton that you would continue to operate this plant merely to produce gypsum with all the overhead you would have?

A. I see no reason why we should not; why, we would cut the overhead down.

Q. In other words, you mean to tell the Court if you should suddenly decide not to manufacture magnesium products in any of these 39 forms or otherwise in which it is manufactured, that you would continue to operate that plant with all this overhead and all this charge merely to produce gypsum?

A. Mr. Bennett, that is not an accounting——

Mr. Rosenberg: Just a minute. I object to that as incompetent, irrelevant and immaterial. The only reason I asked that question was that Mr. Bennett, consistent with the completely illogical theory that

(Testimony of David Watt.)

they have on accounting, asked the witness if we discontinued gypsum, would the plant continue. There is no foundation laid as to whether or not if we discontinued gypsum we could continue making magnesium. It was asked purely for the purpose of demonstrating an accounting item, so I asked him the same question in a different form.

The Court: Magnesia instead of gypsum. [1034]

Mr. Rosenberg: Yes. But I submit there is no foundation laid and it would be completely irrelevant as to whether or not if this plant discontinued one product, it would be economical to continue making another.

Mr. Bennett: I submit it is perfectly proper. Your Honor will recall that four expert accountants stated one of the things to be considered in the character of a by-product was whether its operation would discontinue, if so, whether the other charges would continue notwithstanding, so that has some relevant basis. The only purpose I could see in counsel's question was to inject an element of argument or to have this Court believe that this plant would operate and continue to operate with this large overhead merely to produce gypsum. I thought I was entitled to that.

The Court: Let's get through with the witness.

Mr. Bennett: Q. You are still unable to tell us, Mr. Watt, the percentage of the total bittern cost to the Newark plant that is assessed against gypsum?

A. I believe it is 21 per cent as compared to 79 per cent assessed to oxides. These figures are

(Testimony of David Watt.)

not perfect. I am just mentioning these from my mind.

The Court: That is approximate.

A. That is approximate. That is the ratio.

Mr. Bennett: The value of the gypsum produced at the plant at Newark is about one-twelfth the value of the other [1035] products produced; that is also true, isn't it?

A. I don't know. I would have to check that. I mean, I can not guess at figures like that.

Q. I thought we agreed on that, Mr. Watt.

A. When did we agree on that, Mr. Bennett?

Q. The other day during your testimony.

A. I doubt if I agreed. You said you assumed that.

Q. Well, the record shows that is gone into, your Honor. Are your depreciation records kept at the Newark plant or are they kept at New York?

A. They are kept in New York.

Q. So the matter of allocating against gypsum the depreciation charge that you have set up is done in New York rather than being made at Newark?

A. It is not. It is done at Newark.

Q. I thought you said all the records—

A. The property records of the Newark plant are kept in New York but each month we receive an amount of depreciation which we allocate to the Newark plant.

Q. You mean New York simply advises you that you should depreciate the Newark plant so many dollars? A. Correct.

(Testimony of David Watt.)

Q. You take that direction made in New York and you allocate it down against your various products? A. That is true. [1036]

Q. Is the same thing true of taxes and insurance? A. It is.

Q. Will you again refer to Plaintiff's Exhibit 18 and turn to the second page, the third page, where you have listed, "Overhead and General Plant Expense." I direct your attention to two items which you have listed there for which you have a charge against gypsum, "Research," and "Research New Products," the total of which is set forth in the last period, July 1, 1945 to June 30, 1946 as being \$2622.63 or 7 cents a ton; the preceding period is \$1194.13 and shows a total of—that is a total of \$1194.13 or 3 cents a ton. You are claiming a four cent price increase with this claim of "Research and Research New Products" against cost of manufacturing gypsum. It is a fact, isn't it, Mr. Watt, that in the early period July 1, 1944 to June 30, 1945, you only had charged up to research in that period, up to December of 1944, the sum of \$9.98?

A. That is correct.

Q. Assuming that "Research and Research New Products" had anything to do with the manufacture of gypsum, that gives an erroneous result here as to any actual increase in the prorated cost of that item, does it not?

A. I don't get your question.

The Court: Explain those figures and the differential.

(Testimony of David Watt.)

The Witness: He mentioned a figure of \$9.98 up until December 1944, but this period goes from July 1944 to June 1945, [1037] so what has the \$9.98 got to do with the \$1194?

Mr. Bennett: That is a total charged for six months of only \$9. A. Correct.

Q. In other words, do you want us to understand now that you only allocated \$9.00 to the gypsum during that period of six months?

A. No. The \$9.98 was a direct charge to gypsum and all new products research for that period was done on a governmental research job and nothing was charged to any products at Newark.

Q. You mean you have a direct charge in that period of \$9.98 for research on gypsum?

A. To the gypsum plant.

Q. Do you know what that was for?

A. I definitely don't. It is charged by the research department directly to gypsum.

Q. In other words, the balance of that \$1194.13, is that a direct charge or is that likewise this indirect charge allocated?

A. Partly direct and partly indirect; partly new products.

Q. How much of it is direct and how much of it is other products than gypsum?

A. I can't tell from this sheet. That would have to be worked out separately.

Q. How long would it take you to ascertain that fact? [1038]

A. I would say about three or four days.

(Testimony of David Watt.)

Q. Didn't you have a conversation with Mr. Bannard when he was down at your plant about this very item? A. I did.

Q. You said to Mr. Bannard that an obvious adjustment would have to be made in that first period which would reflect a difference in the amount of any increase in these items of research and research for new products?

A. No. That was for the year 1945.

Q. Yes. A. Not 1944.

Q. You admitted to Mr. Bannard the figure that appeared in that particular item, you would have to make an adjustment to make it correct, didn't you? A. We did make the one—

Mr. Rosenberg: When Mr. Bannard was over there, Mr. Bennett, he was going over the items that showed an 82 per cent increase. This shows a 72 cent increase; the other was 88.

The Witness: 86.

Mr. Rosenberg: One of the items that was adjusted and resulted in this figure was the research item that Mr. Bannard and Mr. Watt discussed. Mr. Flick knows that.

The Court: Call your next witness. Let's get through with this case. Call your next witness. Step down. [1039]

WILLIAM K. WALLACE,

called by the defendant, sworn.

The Clerk: Will you state your name to the Court? A. William K. Wallace.

(Testimony of William Wallace.)

Direct Examination

Mr. Rosenberg: Q. By whom are you employed, Mr. Wallace?

A. Westvaco Chlorine Products Company.

Q. In what capacity?

A. West Coast manager.

Q. How long have you occupied that position?

A. Ten years.

Q. You are familiar with the operations of the corporation at the Newark plant, are you?

A. Yes.

The Court: Pardon me. Will you read that?

(The record was read.)

The Court: You are the manager?

A. Yes.

Q. Manager of the plant at Newark?

A. West Coast manager for all the western operations.

The Court: All right.

Mr. Rosenberg: Q. With reference to the magnesia you have produced at that plant, Mr. Wallace, is the greater part of it sold in bulk or in packages?

A. Approximately 80 per cent of it goes out in bulk, carload [1040] lots, 50 ton cars.

Q. The same as gypsum goes out?

A. I believe gypsum goes out in 40 ton cars in bulk.

Q. With reference to the bittern that is used in the processes over at the plant, can you state

(Testimony of William Wallace.)

whether or not from the time that this contract with Pacific Portland Cement was entered into, whether or not at the Newark plant the company has utilized and extracted all of the gypsum possible from all of the bittern purchased from the Leslie Salt Company?

A. Yes, sir, we have. We have removed all of the sulphate value from the bittern received from the salt companies; that has been removed as gypsum.

Q. Will you state whether or not at all times during the time that this contract has been in effect Westvaco has produced the maximum quantity of gypsum possible from the bittern that the company has had available?

A. That is correct. The production of gypsum is dependent on bittern deliveries from the salt companies and that is dependent upon the weather.

Q. On what? A. The weather.

Q. Is the same thing true as to magnesia? In other words, during all of this period has the plant at Newark utilized all of the bittern and recovered from all of the bittern the maximum amount of magnesia recoverable therefrom? [1041]

A. No, sir. The magnesia available in the bittern has not been required for production of magnesium; that is, all of it has not been required. Part of it is discarded in the Bay.

Q. Part of the bittern after the gypsum—

A. After the gypsum has been removed, part of the magnesia chlorides is returned to the Bay.

(Testimony of William Wallace.)

Q. Let me ask you, is any raw material other than from the bittern used in the production of magnesia at the plant?

A. Yes, a portion of the magnesia that we produce originates from the dolomite that we mine down at Hollister and part of the magnesia that is produced at Newark originates from magnasite that we mine in Nevada.

Q. There has been some talk about the fact that commencing as of a certain period you started to use dolomite over at the plant for the production of magnesia rather than lime; is that correct?

A. That is correct.

Q. Has the amount of dolomite in any wise affected the quantity of gypsum produced?

A. No. It has only affected the quantities of magnesia and not of gypsum.

Q. I will refer your attention to Defendant's Exhibit J which shows the quantity of magnesia and gypsum produced in the various periods which are involved in this case. Can you explain why the relation between magnesia products and gypsum products [1042] in the various periods is not constant?

A. I think that has been explained in the answers I have given before. Part of the magnesia originates from magnasite ore and dolomite ore and part of it from the bittern supply, whereas all of the gypsum originates from the bittern supply.

Q. So that the figures that occur on this sheet indicating the amount of magnesia produced, that

(Testimony of William Wallace.)

is not exclusively magnesia produced from bittern?

A. That is correct.

Q. Were you in court when Mr. Flick testified to a conversation that you and he had shortly prior to September 1, 1946, at which time you informed Mr. Flick that unless Pacific would pay the price that Westvaco asked or felt it was entitled to, Westvaco would discontinue the shipment of gypsum; do you recall that?

A. I was not present at that time, but I do recall the session that I had with Mr. Flick.

Q. You did have a conversation at or about that time with Mr. Flick? A. Yes.

Q. Was that over the telephone or—

A. That was a telephone conversation.

Q. What did you say to Mr. Flick in that conversation regarding discontinuing the shipment of gypsum?

A. Well, Mr. Flick, I believe, made the comment that we were [1043] dumping, or asked what we were going to do with the gypsum while they were not getting deliveries, and I believe in indicated to him that if it continued very long, we would have to dump it out in the flat.

Q. Did Westvaco in fact discontinue shipments of gypsum to Pacific Portland Cement Company on or about September 1, 1946?

A. Yes; we discontinued shipments September 1 for a period of about two weeks.

Q. At any time following September 1, 1946, did you have any conversation with Mr. Flick in

(Testimony of William Wallace.)

which you told him what you were doing with the gypsum during the period that no deliveries were being made to Pacific Portland Company?

A. No, sir.

Q. Did Westvaco in fact discontinue production of gypsum during that period?

A. We produced gypsum part of the period. We did make an installation of this panel mixer that has already been brought into the record, during that period the plant was down for a period of about five or six days to install the panel mixer.

Q. During the balance of the time—

A. During the balance of the time we produced gypsum.

Q. What was done with that gypsum?

A. We put it in the warehouse.

Q. At that time had Westvaco utilized the 4,000 tons that it was entitled to produce and retain for its own use under the [1044] contract?

A. No. We put that in storage for chemical uses.

Q. For your own uses under the contract?

A. That's right.

Mr. Rosenberg: Now, I might say, Mr. Bennett, that at your request I have here the records showing the production of gypsum during that period.

Mr. Bennett: Well, I would like to see it, counsel. I asked for them long ere this. Before you use them, I want to examine them.

Mr. Rosenberg: I am not going to use it.

The Court: Very well. We will take a recess and you can submit it.

(Testimony of William Wallace.)

Mr. Rosenberg: May I say this—

Mr. Bennett: May I look at these documents during the recess?

The Court: Yes.

Mr. Rosenberg: May I say this, your Honor: These consist of weekly reports consisting of three pages. On the last page it shows the sales that Westvaco has made of various products during the period. Now, I propose to detach the third page. It has no relevancy to the information that Mr. Bennett is seeking and it has the form of what we believe is confidential business information.

Mr. Bennett: Wait a minute. If it ties in with this, Mr. [1045] Rosenberg, I don't think—

Mr. Rosenberg: It does not tie in with the other information. It is merely a report of our sales during the period covered by the report.

Mr. Bennett: It think that may have a bearing on exactly what the witness has been testifying to.

The Court: We are not having any concern here about sales, are we?

Mr. Rosenberg: You want to know what was produced, don't you?

Mr. Bennett: Yes.

Mr. Rosenberg: All right. I will give you all the information you want on that.

The Court: Very well. We will take a recess until 2:00 o'clock.

(Whereupon an adjournment was taken until 2:00 o'clock p.m. of the same day.) [1046]

(Testimony of William Wallace.)

Tuesday, December 30, 1947, 2:00 o'clock p.m.

The Court: You may proceed.

(William K. Wallace resumed the stand.)

Direct Examination—(Continued)

Mr. Rosenberg: Q. Mr. Wallace, I show you reports which purport to be stock reports for Newark and Chula Vista plants for the week ending September 6, 1946, and the same for the week ending September 13, 1946, and the same for the week ending September 20, 1946. (Addressing the Court) I might say, your Honor, that counsel, Mr. Bennett, has inspected these. Mr. Wallace, are those the reports of the Newark plant showing the production among other things of the gypsum that is produced at the Newark plant?

A. Yes, sir.

Q. There is a column there entitled "Gypsum Produced," or words to that effect. Is all of that gypsum produced in the Newark plant, or do you produce gypsum in any other plant than the Newark plant?

A. No, it is all produced in the Newark plant.

Q. Will you state the amount of gypsum produced in the week ending September 6, 1946?

A. 279 tons.

Q. Will you state the amount of gypsum produced in the week ending September 13, 1946?

A. 262.2 tons.

Q. Will you state the amount of gypsum produced in the week ending September 20, 1946?

(Testimony of William Wallace.)

A. 445 tons.

Q. I believe you stated during that period of time the gypsum plant was down for repairs for six days. Can you tell me what period of time that six days covered?

A. From September 4 to September 9, inclusive.

Mr. Rosenberg: I will offer those in evidence as a group, if the Court please, as Defendant's Exhibit next in order.

Mr. Bennett: What about the last week? I think I asked for the whole month of September, counsel. Do you have the following week?

Mr. Rosenberg: Q. Do you have the report of the following week?

A. I didn't bring that. We have it in Newark.

Mr. Rosenberg: I thought you were interested in the period from September 1 to 13.

Mr. Bennett: I was interested also in the period for the balance of the month.

The Court: It may be admitted and marked.

(Report of production for weeks ending September 6, 13 and 20, 1946 was thereupon received in evidence and marked Defendant's Exhibit K.)

DEPARTMENT OF THE ARMY NO. K. Endorsed 7: Filed 11-30-47

PAGE 1.

From
Williams
Gilbert
Clinton
Kron-2
Hylan

Salmon
Stark
Bradley
Dale
Martin
Cimino
Chapman Braman

STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

Week Ending Sept. 20, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
Unslaked Dolomite	Tons	822.55	45.40 403.56	Slaker	733.06		538.45
Quicklime	T	345.95	280.50	Hydrated Slaker	19.85 75.04		531.56
Hydrated Lime "A" Grade	T	2.60	** 20.20 24.00	M S		1.00	45.80
Hydrated Lime "B" Grade	T	9.25	* 2.50	M S			11.75
Perioliase #S-90	T	1406.14	372.99				1778.13
Perioliase #S-93	T	385.49					385.49
20 Mesh #S-90 and #S-93 Fines	T	80.25	49.12				129.37
2631-R, Bulk	T	48.05	17.55	Feed #2	27.47		38.15
Chloride Free MgO 2661 Bulk	T	152.78	82.06	Bagged	27.70		207.16
Chloride Free MgO 2661 Gran. Bag	T						
Chlor. Free MgO 2661 Powd. Bag	T	92.10	27.70	Rayon	50.00		69.80
Rayon Grade	T		50.00			50.00	
Quick MgO #2663 Bulk	T	131.75		Bagged			131.75
Quick MgO #2663 Gran. Bagged	T						
Quick MgO #2663 Powd. Bagged	T	.27					.27
				Dry Slaked Powdered	43.67 3.94 53.89		
Chem. Prop. MgO #2665 Bulk	T	234.68	79.84	Bagged			204.84
Chem. Prop. MgO #2665 Gran. Bag	T	32.92	53.89	2652-S	.93		68.72
Chem. Prop. MgO #2665 Pwd. Bulk	T		3.94	Bagged	17.17 3.94		
Chem. Prop. MgO #2665 Pwd. Bag	T	5.43	* 5.66	2652-S	11.09		
Chem. Prop. MgO #2665 Double Kill	T	6.65					6.65
#2662 Gran.	T	22.94	17.17			40.01	
#90 Perioliase Bagged	T	1.00					1.00
C-D Grade	T	6.75					6.75
#90 & #93 Fines Pwd.	T	22.20					22.20
#2665-M Pwd. Bag	T	3.57					3.57

NEWARK CHULA VISTA PLANT

Aug 7.

Week Ending Sept. 20, 6:00 A.M., 1946

REMARK	Opening Balance	Made or Received	USED		Shipped	Closing Balance
			Purpose	Quantity		
#2641 Adsorptive Powdered Lbs.	1807				4	1803
#2642 Adsorptive Powdered Lbs.	7892					7892
#2652 Adsorptive Granular Lbs.	9052	25,800				34,952
Sierra Oxychloride Bulk Tons	90.50	224.46	Blend-Bag Gran.Bag	80.37 92.83		141.13
Sierra Oxy. Granular Bagged T	175.35	92.83				268.18
Straight Oxy. Powd. Bagged T						
Sierra Oxy. & #2665 Powd.Bag T	507.70	167.64			280.56	414.60
Gypsum, Bulk T	508.20	445.00	Bagged Bag & Shipped for PFC	80.00	100.00 14.13	785.17
Gypsum, Bagged T	10.00	80.00			80.00	10.00
Magnesia Sludge T	337.35	578.80	Fed Kilns	547.54	39.57	329.02
Bromine Lbs.			Dibromide			
Ethylene Dibromide, Newark Lbs.	115,770					115,770
Compressed Ethylene Lbs.	2049	600			900	1759
Heptane Gal.	81.50					81.50
Kellstone Sleepers Ft.						
Shell Yds.	6257	1027	Quicklime	1626		5630
Sierra Crude Ore T	1013.17		#6 Kiln	376.34		636.83
Western Chips T	333.85	101.77	#6 Kiln	204.26		231.88
Heavy Fuel Oil Gal.	146,171		#2 Kiln	51,038		95,133
Crude Dolomite T	807.49	534.03		838.27		503.23
CHULA VISTA Liquid Magnesium Chloride Gal.			To Flare			
CHULA VISTA Flake Magnesium Chloride T						

W

W Thom
Williams
M Gilbert
DClinton
Dixon-2
J Rylan

Wallace
Stark
Bradley
Dale
Martin
Cimino
Chapman Braman

STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

Week Ending September 13, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
Calained Dolomite	Tons	643.85	925.69	Slaker	746.99		822.55
Quicklime	T	363.94	--	Hydrated Slaker	15.75 2.24		345.95
Hydrated Lime "A" Grade	T	1.60	15.00	M S		14.00	2.60
Hydrated Lime "B" Grade	T	10.00	5.00	M S	5.75		9.25
Scamter Periclase #S-90	T	1100.56	304.56				1405.14
Scamter Periclase #S-93	T	384.23				1.26*	385.49
-20 Mesh #S-90 and #S-93 Fines	T	91.09	42.26			53.10	80.25
#2661-R, Bulk	T	113.87	2.50	Powd #2	68.32		48.05
Chloride Free MgO #2661 Bulk	T	60.70	92.08	Bagged			152.78
Chloride Free MgO #2661 Gran.Bag	T						
Chlor. Free MgO #2661 Powd.Bag	T	92.10					92.10
Quick MgO #2663 Bulk	T	131.75		Bagged			131.75
Quick MgO #2663 Gran.Bagged	T						
Quick MgO #2663 Powd. Bagged	T	.27					.27
Chem. Prep. MgO #2665 Bulk	T	183.49	#3 101.22 #4 88.93	Oxy Blend Powdered #2662 Gr. Bagged	97.36 22.84 18.76		234.68
Chem. Prep. MgO #2665 Gran.Bag	T	14.16	18.76				32.92
Chem. Prep. MgO #2665 Pwd.Bulk	T			Bagged			
Chem. Prep. MgO #2665 Pwd. Bag	T	5.43					5.43
Chem. Prep. MgO #2665 Double Mill	T	6.65					6.65
#90 Periclase Bag	T	1.00					1.00
C-D Grade Bag	T	6.75					6.75
#90 & #93 Fines Pwd. Bag	T	22.20					22.20
#2665-R Pwd. Bag	T	22.57					22.57
#2662 Gran Bag	T	22.84					22.84

(*) - Adjustment

STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

PAGE 2.

Week Ending September 13, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
#2641 Adsorptive Powdered	Lbs.	1617				10	1607
#2642 Adsorptive Powdered	Lbs.	7897				5	7892
#2652 Adsorptive Granular	Lbs.	297	8760			5	9052
Sierra Oxychloride Bulk	Tons	92.28	213.51	Blend-Bag Gran.Bag	131.49 83.80		90.6
Sierra Oxy. Granular Bagged	T	141.55	53.80				175.3
Straight Oxy. Powd. Bagged	T						
Sierra Oxy. & #2665 Powd.Bag	T	413.86	2665-97.36 Oxy-181.49			185.00	507.7
Gypsum, Bulk	T	284.00	262.20	Bagged Bag & Shipped for PPC	40.00		506.2
Gypsum, Bagged	T	10.00	40.00			40.00	10.0
Magnesia Sludge	T	440.68	591.35	Fed Kilns	660.68	54.70	537.3
Bromine	Lbs.			Dibromide			
Ethylene Dibromide, Newark	Lbs.	115,770					115,77
Compressed Ethylene	Lbs.	1789.00	300.00			50.00	2059.0
Heptane	Gal.	86.50				5.00	81.5
Kellestone Sleepers	Ft.						
Shell	Yds.	5230	1027	Quicklime			5257
Sierra Crude Ore	T	1329.23	56.01	#5 Kiln	372.07		1013.1
Western Chips	T	436.32	93.86	#5 Kiln	196.33		333.8
Heavy Fuel Oil	Gal.	199,328	50.66	#2 Kiln	48,071		146,17
Crude Dolomite	T	2307.01	450.48	#1 Kiln	1950.00		807.4
CHULA VISTA Liquid Magnesium Chloride	Gal.	141,550	13,400	To Flake	4,900		150,05
CHULA VISTA Flake Magnesium Chloride	T	41.75	23.75				55.5

AIR MAIL

Thoma
Williams
Gilbert
Clinton
Dixon-2
Hylan
Salas
Stark
Bradley
Dale
Martin
Cimino
Chairman Branen

STOCK REPORT - NEWARK AND COLUMBIA VISTA PLANTS

Week Ending Sept. 6, 1946 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	Purpose	Quantity	Shipped	Closing Balance
Calcined Dolomite	Tons	487.11	842.00	Slaker	686.26		643.85
Quicklime	T	389.52		Hydrated Slaker	25.58		353.94
Hydrated Lime "A" Grade	T	29.10	22.50	M S		50.00	1.60
Hydrated Lime "B" Grade	T	8.75	10.00	M S	8.75		10.00
Seawater Periclase #S-90	T	1087.58	163.00			150.00	1100.58
Seawater Periclase #S-93	T	434.23				50.00	394.23
20 Mesh #S-90 and #S-93 Fines	T	66.59				.50	91.09
#2661-E, Bulk	T	117.70	5.00	Fed	8.85		113.87
Chloride Free MgO 2661 Bulk	T	30.70	30.00	Bagged			60.70
Chloride Free MgO 2661 Gran.Bag	T						
Chlor. Free MgO 2661 Powd.Bag	T	92.10					92.10
Quick MgO #2663 Bulk	T	131.75		Bagged			131.75
Quick MgO #2663 Gran.Bagged	T						
Quick MgO #2663 Powd. Bagged	T	.27					.27
Chem. Prep. MgO #2665 Bulk	T	138.83	162.00	Oxy Blend Powdered Bagged	91.11 37.65		183.49
Chem. Prep. MgO #2665 Gran.Bag	T	65.59	5.61	To Bulk 2662	16.95 40.01		14.16
Chem. Prep. MgO #2665 Pwd.Bulk	T	--	37.65	Bagged	37.65		--
Chem. Prep. MgO #2665 Pwd.Bag	T	--	37.65	To 2662-S Research	11.81 .60	20.01	5.43
Chem. Prep. MgO #2665 Double Mill	T	6.65					6.65
20 Periclase Bag	T	1.00					1.00
20 Grade Bag	T	6.75					6.75
#90 & #93 Fines Prod. Bag	T	22.20					22.20
#2661-E Pwd. Bag	T	3.57					3.57
#2662 Gran. Bag	T		40.01			40.01	

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STOCK REPORT - NEWARK AND CHULA VISTA PLANTS

PAGE 2.

Week Ending Sept. 6, 8:00 A.M., 1946

NEWARK		Opening Balance	Made or Received	USED		Shipped	Closing Balance
				Purpose	Quantity		
#2641 Adsorptive Powdered	Lbs.	1617					1617
#2642 Adsorptive Powdered	Lbs.	7897					7897
#2652 Adsorptive Granular	Lbs.	297					297
Sierra Oxochloride Bulk	Tons	110.87	186.00	Blend-Bag Gran.Bag	159.19 35.40		92.
Sierra Oxy. Granular Bagged	T	106.15	35.40				141.
Straight Oxy. Powd. Bagged	T						
Sierra Oxy. & #2655 Powd.Bag	T	333.55	280.30			180.00	413.
Gypsum, Bulk	T	291.26	279.00	Bagged Bag & Shipped for PFC	150.00	84.28 50.00 42.00	284.
Gypsum, Bagged	T	--	150.00			120.00	10.
Magnesia Sludge	T	390.02	505.00	Fed Kilns	398.58	4.81 51.15	440.
Bromine	Lbs.			Dibromide			
Ethylene Dibromide, Newark	Lbs.	124,770				9,000	115,7
Compressed Ethylene	Lbs.	319.00	1500.00			30.00	1789.
Heptane	Gal.	86.50					86.
Kellestone Sleepers	Ft.						
Shell	Yds.	4,203	1,027	Quicklime			5,230
Sierra Crude Ore	T	1553.94	218.83	#5 Kiln	243.54		1329.
Western Chips	T	570.14		#5 Kiln	133.82		436.
Heavy Fuel Oil	Gal.	220,736		#2 Kiln	21,408		199,3
Crude Dolomite	T	3339.24	889.85	#1	1922.08		2307.
CHULA VISTA Liquid Magnesium Chloride	Gal.	132,750	18,900	To Flake	10,100		141,6
CHULA VISTA Flake Magnesium Chloride	T	50.75	32.00			41.00	41.

(•)-- Aug. ship. adj.

(Testimony of William Wallace.)

Mr. Rosenberg: Q. Mr. Wallace, will you state how many [1048] employees are employed at the Newark plant in the gypsum department in connection with the direct labor that is devoted to the processing and production of gypsum.

A. Four chemical operators—four men.

Q. Those are the men who perform the labor that is designated as direct labor on gypsum exclusively, is that correct? A. That's right.

Q. How many employees did you have in the magnesia plant performing direct labor that is charged as such in the magnesia department?

A. Thirty-two men.

Q. How many employees did you have in the plant performing maintenance or repair labor?

A. Forty-three men at the present time.

Q. How would their time be charged, do you know?

A. It is all on the time card basis.

Q. In other words, the work that they perform in connection with gypsum equipment is kept on a time card record and charged directly to gypsum?

A. That's correct.

Q. And the same is true of magnesia or bromine when you are making bromine?

A. That's right.

Mr. Bennett: As to that matter, counsel, we are not in any dispute in this trial as to the propriety of the direct [1049] charges of these maintenance repair men that are actually engaged

(Testimony of William Wallace.)

in time actually kept for anything having to do with gypsum.

Mr. Rosenberg: That's right.

Q. There had been some mention of charges made for so-called exploration. What does that represent?

A. The exploration work that we do at Newark—we have two mining engineers located there who direct exploration work on mining properties, such as dolomite in Hollister. We put on a private drilling campaign down there to explore a large deposit of dolomite which is a source of raw material for the Newark plant at the present time.

Q. Is that dolomite used in any way in the production of gypsum?

A. You couldn't produce gypsum without the calcium that originates in the deposit down at Hollister. That is where calcium originates for the gypsum.

Q. Does this exploration work involve exploration of any mining operations other than mining of calcium products?

A. Yes, it does; these two mining engineers who are located at Newark also do exploratory work on magnasite.

Q. Does the magnasite have any relation or function in the manufacture of gypsum?

A. Not in the manufacture of gypsum, but it does have to do with the production of all magnesia products at Newark. [1050]

Q. Now, also, there has been some mention of a portion of New York office expense allocated to

(Testimony of William Wallace.)

the Newark plant, the amount of which was allocated to gypsum in the period 1945-1946 was \$671. Have you been in the New York offices of the Westvaco Company? A. Yes, sir.

Q. What do they consist of?

A. The New York offices consist of four floors in the Chrysler Building.

Q. Do you know approximately how many employees they have there?

A. About 150 employees.

Q. Are you familiar with the provision of the contract which entitles Westvaco to retain up to 4,000 tons of gypsum processed at the Newark plant for sale by Westvaco for pharmaceutical, scientific and chemical purposes, are you?

A. Yes, sir.

Q. Now, does Westvaco in fact sell that gypsum for those purposes?

A. We sell some gypsum for those purposes.

Q. Is the gypsum that you sell for those purposes any different than the gypsum that is delivered to Pacific Portland Cement Company?

A. No, the gypsum for those uses all comes out of the same bin from which we take the gypsum for Pacific Portland. The only [1051] difference is part of the gypsum is put in bags and shipped out in 100 pound bags instead of shipping it in bulk, and there have been occasions when a portion of it was ground. That is the only treatment that gypsum gets.

Q. With reference to the plant additions that have been made to the gypsum plant as testified

(Testimony of William Wallace.)

to by Mr. Watt, can you state what the purpose was of those additions?

A. Most of the additions were for the purpose of increasing the capacity of the plant, the gypsum plant.

Q. There has been some mention of plant guards at the Newark plant, and the suggestion has been made that that was a matter of war necessity. Do you still have plant guards at the plant?

A. Yes, we have.

Q. Is that required under any contract or government regulation? A. No, sir.

Mr. Rosenberg: That's all. Oh, just one further question.

Q. When did you first start employing guards at the plant, do you recall?

A. Late in 1940.

Mr. Rosenberg: That's all.

Cross Examination

Mr. Bennett: Q. Now, these charts or forms which are Defendant's Exhibit K, for these periods ending September 20, there are types of gypsum listed. One is gypsum "bulk" and [1052] underneath that "gypsum bag." Why are they kept in different categories so far as the production figure is concerned?

A. The gypsum that is marked "gypsum bag" was chemical gypsum—what we call chemical gypsum for chemical or pharmaceutical purposes.

Q. The gypsum that you do or do not call "bag."

(Testimony of William Wallace.)

A. The gypsum that is called "bag" is used to designate that gypsum that we reserve for sale for chemical purposes or for pharmaceutical purposes.

Q. Gypsum which is manufactured for chemical or pharmaceutical purposes has to be freer from impurities and deleterious matter than the gypsum that is sold to Pacific Portland Cement Company for construction purposes, is it not?

A. Well, this gypsum that we produce at Newark is of such purity that every ton of it could be shipped out as Food Grade Gypsum.

Q. In other words, you produce your gypsum down there so that you can take out of any batch gypsum that will measure up to the purity requirements for chemical or pharmaceutical purposes, is that correct?

A. That's correct.

Q. And you sell approximately 4,000 tons a year of gypsum to customers other than Pacific or for chemical or for pharmaceutical purposes?

A. That tonnage varies, I believe, between 2,000 and 3,700 tons [1053] in the last ten years.

Q. You get a higher price for that than you do for ordinary bulk gypsum that is used for construction purposes?

A. Yes, sir.

Q. Did you actually ship to Pacific Portland Cement Company during this period from the week ending September 6 to the week ending September 13 any gypsum?

A. No, sir.

Q. Well, take this first week of September. It seems, as I read these figures, that there are three

(Testimony of William Wallace.)

items of tonnage, 64.26, 50 tons and 42 tons that are under the column "Shipped." This is gypsum bulk?

A. That was shipped — some gypsum was shipped on August 31 to Pacific Portland. Nearly 100 tons were shipped on that day—two carloads.

Q. Where was this other ton, the amount in excess of the 100 tons of this total produced in that period shipped—to some other customer?

A. Possibly to one of the chemical accounts—bag material.

Q. You also show that you produced during that week 130 tons of bag gypsum and you shipped 120 tons of that out. Was that to your other pharmaceutical and chemical customers?

A. That's correct.

Q. The first time you began using this dolomite in the precipitation of magnesium oxide from the bittern water was when [1054] Mr. Wallace? When did you first start using dolomite down at your Newark plant?

A. I believe it was early in 1943, some time in 1943.

Q. And prior to that time you were using lime?

A. That's correct.

Q. Why did you change from the lime to the dolomite?

A. We were short of bittern. We were not receiving enough bittern from the salt companies to take care of the requirements and by substituting

(Testimony of William Wallace.)

dolomite for lime we were able to increase the output of our magnesium products.

Q. But by the same token you decreased the relative amount of gypsum produced, did you?

A. No, sir, the sulphate values were not available in bittern received from the salt works to produce any more gypsum.

Q. I want to call your attention to Plaintiff's Exhibit 18 of the summary sheet. It shows in the calendar year 1942 you produced 31,826 tons of gypsum, isn't that correct? A. That's right.

Q. The following year, the calendar year 1943, after you started using dolomite, your gypsum production was reduced to 24,431 tons, is that right?

A. That's right.

Q. The actual production of magnesia in that period increased, did it not, from 34,077 tons in 1942 to 37,671 tons in 1943?

A. I believe those are the figures. [1055]

Q. So you had in that comparative period a substantial increase in the total tonnage of magnesia produced and a consequent decrease of at least, approximately 23 per cent in tonnage of gypsum produced, did you not?

A. That is correct, and that is due entirely to shortage of bittern.

The Court: "Due entirely to the shortage of bittern," the witness said.

Mr. Bennett: Q. You mean the decrease—

A. In the gypsum.

(Testimony of William Wallace.)

Q. The decrease in the gypsum and the increase in magnesia was due to the fact that you brought in dolomite? A. Dolomite.

Q. And you have used dolomite ever since that time?

A. We have used some dolomite since then and here recently, a few months ago, we went to 100 per cent dolomite.

Q. But since you first started to use it in 1943, the principal agent that you had for precipitating the magnesium oxide in bittern water was dolomite?

A. That was the case in '45 and '46. We used small amounts of dolomite, but we were not running on 100 per cent dolomite.

Q. Now, 1943 you were desirous of stepping up and producing the very maximum amount of magnesia products that your plant was capable of producing, weren't you?

A. All of the magnesia products that we could produce, that's [1056] correct?

Q. And that continued for a period of time after that, didn't it, during the war years?

A. It went on through 1944 and part of 1945, yes.

Q. During that period of time when you were endeavoring to produce all of the magnesium oxide that you could, were you disposing otherwise of any of the magnesium chloride?

A. Yes, during periods when we were using dolomite we were disposing of magnesium chloride.

Q. The magnesium chloride contained magnesium oxide, didn't it?

(Testimony of William Wallace.)

A. Yes, but we didn't have plant facilities to process that tonnage. We could get more tons of dolomite sludge than lime sludge.

Q. You had to dispose of some of the magnesium chloride because of the limitation of your plant facilities to handle all the magnesium chloride that would—

A. We were interested in producing every ton of gypsum we could get out of the plant. That was the reason of disposal of some of the magnesium chloride.

Q. But when you had demand for magnesium chloride, magnesium oxide was your principal product, wasn't it, so far as dollar sales value was concerned?

A. The magnesium oxide was one of the main products.

Q. You received per ton for magnesium products at least 12 [1057] times what you receive for gypsum, don't you? A. No, we never have.

Q. Well, Mr. Watt stated here that the price per ton of magnesium oxide was, as I recall, 30 and some dollars per ton up to 60 or more dollars per ton, isn't that correct?

A. No, sir, the price for magnesium oxide varied, but when we are talking about the average return on magnesia products, it is at a much lower level than the figure mentioned in this court.

Q. What is the current quotation of magnesium oxide at your plant?

A. I am referring to the prices that were in effect in 1946, 1945 and 1944, the period under discussion.

(Testimony of William Wallace.)

Q. Yes.

A. At that time our average price was nearer \$30 than this \$60 figure that has been bounced around here.

Q. What is the price of just plain magnesium oxide down there in bulk?

A. We sell some down there for \$36, some for \$39 and some for \$42.

Q. That is sales on contract made at some previous time, isn't it?

A. No, those prices are adjusted now on a quarterly basis.

Q. What would you say the highest price magnesium produce per ton that you produce there is at this time? [1058]

A. We have some special magnesia products sold in small quantities to certain customers that bring in \$60, but that amount is small.

Q. The lowest price for magnasite at your plant now, for the crude product, is how much per ton?

A. We don't consider it a crude product. It is a high grade product and we have some of it going out at \$36.

Q. And it goes, then, in price from \$36 upward?

A. That's right, but the big tonnage is in the lower bracket.

Q. You mean the larger portion of it is \$36 per ton.

A. It is in the lower bracket. I think I indicated that the average price in 1944 and 1945 was nearer \$34 and \$30 than it was nearer \$46.

(Testimony of William Wallace.)

Q. Well, even so, that is at least ten times the value of the tonnage price of gypsum other than your pharmaceutical or chemical gypsum, isn't it?

Mr. Rosenberg: You mean the contract price, do you, Mr. Bennett? He is talking about market price. Are you talking about market price or contract price?

Mr. Bennett: You have no market, counsel, for this bulk gypsum that is not sold for chemical or pharmaceutical purposes except to us. As I understood, during those periods there was asked a price of \$3.76 a ton. That price would be approximately one-tenth or thereabouts of the price per ton of what the witness says is the average. [1059]

Mr. Rosenberg: Well, you have a convenient way of leveling off figures. I would say that \$3.76 per ton is not one-tenth of \$30. It is one-tenth of \$37.60.

Mr. Bennett: Well, he said \$36 was the average that he gave.

Mr. Rosenberg: No, it was not.

Mr. Bennett: Well, you and I differ apparently as to what the witness' testimony is.

Mr. Rosenberg: I think we should stay with the record on that.

Mr. Bennett: Q. How much bittern is required to manufacture a ton of dried and ground gypsum at your plant in the process you use down there at Newark? A. I don't have that figure.

Q. You don't know?

A. I don't know that figure.

(Testimony of William Wallace.)

Q. You have, do you not, a contract with the Leslie Salt Company whereby you take their entire output of bittern?

A. I would say we take most of it.

Q. Under a contract with them?

A. Yes.

Q. Unless you use all of the bittern that you are obligated to take from them, why, it would be a complete waste, wouldn't it?

Mr. Roesnberg: I guess anything you buy and don't use is [1060] a waste. I don't get the point.

Mr. Bennett: Well, the witness would know that.

Q. Any bittern you didn't use in the manufacture either of the various magnesium products or gypsum you would have to dispose of as a waste, wouldn't you?

A. I think we would store it for some future use.

Q. You are endeavoring to make some use of all of the bittern that you are required to receive under your purchase contract with the Leslie Salt Company, aren't you?

A. That's right. We are trying to find outlets.

Q. And the main purpose of this bittern so far as relative values is concerned, is used in the manufacture of magnesium oxide, isn't it?

A. Gypsum and bromine when we have a market for bromine.

Q. In treating the matter of allocation by this arbitrary method that Mr. Watt says that you

(Testimony of William Wallace.)

assign the cost of bittern to magnesia products and to gypsum, by far the largest portion of the cost of the bittern is assigned to the magnesia products, isn't it? A. Yes.

Q. So that you would say that the principal purpose and use of the bittern is in the manufacture of the magnesium oxide, isn't it?

A. I wouldn't say that because from year to year I have considered that the distribution cost of bittern has to be on the [1061] proper basis. I think we should take the constituent parts of that and charge it on the basis of sulphate content used in the gypsum.

Q. Well, coming now not to what you think should be done, but taking what you have done through the years, from the time the contract has been in operation up to now, so far as allocation of costs are concerned, you have considered magnesium is the principal purpose for which the bittern is purchased, have you not? A. Yes.

Q. All right. You can not manufacture magnesium oxide down in this plant, the way this plant is equipped, without using bittern, can you? In other words, bittern is the essential raw product with certain things added to it by which you make magnesium oxide? A. That's correct.

Q. I am directing your attention, Mr. Wallace, to a conversation which you had with Mr. Flick on or about the 6th of September 1946. Do you recall such a conversation in which the subject of your continued manufacture and delivery of gyp-

(Testimony of William Wallace.)

sum to Pacific Portland Cement Company was discussed?

A. Was it a telephone conversation? I recall a telephone conversation with Mr. Flick.

Q. Concerning that subject matter?

A. Yes. [1062]

Q. At that time did you tell Mr. Flick on the 5th of September — I said the 6th before — that there would be no gypsum production until Pacific accepted your proposal as to price and other conditions in future deliveries?

A. I remember that.

Q. And you stated that to Mr. Flick, did you?

A. There would be no more production for their consumption.

Q. Yes. At that time did you not tell Mr. Flick that you were pumping this calcium sulphate out into the Bay?

A. I believe he asked the question whether we were pumping it out into the Bay. I don't know whether he said, "into the Bay" or "into the flat," but in previous discussions I have always referred to pumping it into the flat, but in any event I believe he asked the question if we were pumping it into the flat, and I certainly would not have told we were pumping it out if we were putting it in the warehouse. I think I told him the time would come when we would soon have to pump it out into the flat. It would all depend on how long they were going to hold up payment on gypsum. If he had told me right then and there that they

(Testimony of William Wallace.)

were going to refuse to pay the price for three or four months, there was no question but that some of that gypsum would be pumped out into the flat. After our warehouse was full, we would have to do something with it.

Q. But you told him at that time you were pumping it out into the Bay? [1063]

A. No, sir, I did not.

Q. Didn't he ask you what you were doing with the gypsum?

A. I think he asked what we were doing with the gypsum, if we were pumping it out in the flat, or he may have said, "pumping it out in the Bay," and I told him the time would probably come when we would have to.

Q. And when that time would come you would still continue your operations of manufacturing magnesium oxide?

A. Will you read that question again?

(Question read.)

The Witness: A. Well, we had plans to produce a different product other than gypsum which would require a few months time in converting our equipment over.

Q. You mean to make a new product out of this sulphate that had to be taken away from the bittern water in order to produce magnesium oxide?

A. That's correct.

Q. Did you tell Mr. Flick you were proposing to do that?

A. Not in that conversation, but a few months prior to that I indicated to him research department was doing work which would lead to that.

(Testimony of William Wallace.)

Q. So you would stop the production of gypsum and make some other product—

A. That's right.

Q. Was some of the research that was involved in this project [1064] research that was allocated against the cost of gypsum by your plant down there?

A. It very likely could have been.

Mr. Bennett: That's all, Mr. Wallace.

Redirect Examination

Mr. Rosenberg: Just one question:

Q. Can you manufacture gypsum at the Newark plant without using bittern?

A. No, we can not.

Q. I may have asked you this, but will you state whether or not the reduction in the quantity of gypsum produced in 1943 as compared to the year 1942 was in any wise the result of or attributable to the use of dolomite in the magnesia process?

The Witness: Would you read that question, please?

(Record read.)

The Witness: The answer is no.

Q. Can you state this, whether or not in the year 1943 you utilized all of the bittern that was available from the Leslie Salt Company in the production of the maximum amount or quantity of gypsum that could be recovered therefrom?

A. Yes, we did.

Mr. Rosenberg: That's all.

The Court: Call your next witness.

Mr. Bennett: If your Honor please, counsel has agreed we may put on out of order Mr. Colton. He is a resident of Reno [1065] and has business up there. He is the gentleman referred to in Mr. Barrows' testimony and I would like to put him on for three or four questions.

The Court: Very well.

JAMES H. COLTON

called as a witness on behalf of plaintiff in rebuttal out of order, sworn.

The Clerk: Q. Will you state your name to the Court? A. James H. Colton.

Direct Examination

Mr. Bennett: Q. Mr. Colton, you are the Mr. Colton who was vice president in charge of operations for Pacific Portland Cement Company in the years 1936-1937 with whom the negotiations were conducted with Mr. Barrows relative to the purchase by your company and the sale by Mr. Barrows' company, the California Chemical Corporation, of certain gypsum, and which culminated in the contract which is involved in this case, January 29, 1937? A. That is correct.

Q. State whether or not at any time before or after you received Mr. Barrows' letter of June 5, 1936, which is in evidence in this case and is a letter of September 18, 1936, with the accompanying draft of agreement which is also in evidence here, and up to and including the time of the contract of [1066] January 29, 1937 was actually executed, Mr. Barrows or anyone else representing

(Testimony of James H. Colton.)

the defendant, stated or in any way suggested to you that any price increase over the stated price of \$2.80 per ton should be based on any items other than direct costs of the manufacture of gypsum?

A. No. [1066-A]

Q. Did Mr. Barrows, at any time during your negotiations with him ever state to you, or did you state to him, that you would insert in the contract the words "Cost of production," and leave that up to the accountants to determine what those costs were? A. My answer would be no.

Q. Now, Mr. Colton, from the date of this contract in January of 1937 up until the time that the defendant notified your company of of the second price raise, did anyone representing either your company or the defendant ever say or suggest to you in any way that the defendant claimed or was claiming the right to increase the price for gypsum under the contract, based on any increase of indirect overhead items of cost?

A. They did not.

Mr. Bennett: You may take the witness.

Cross Examination

Mr. Rosenberg: Q. Mr. Colton, you negotiated this contract with Mr. Barrows, did you?

A. Up to the time it was submitted to the attorneys.

Q. Nobody else took any part in the negotiations but you, yourself?

A. That's right; I negotiated the contract. The final draft was left in the hands of the attorney. I negotiated; I with Mr. Barrows.

(Testimony of James H. Colton.)

Q. And nobody else on behalf of your company had anything to do with those negotiations, did they? [1067] A. That's right.

Q. When did those negotiations start?

A. Well, the actual negotiations got going sometime in the middle of '36. We had had conversations over a long period of time, the exact date I couldn't state; but I had known Mr. Barrows, and during the time that he was experimenting at Westvaco or at Newark, at various times he had talked to me, and I don't think we got to the point of discussing a contract until probably in the middle of '36.

Q. Up to that point your discussions were purely casual? A. Very general.

Q. Were preliminary, were they?

A. Very general up to that time.

Q. They continued until when? Until sometime in September, 1936, isn't that correct?

A. That is right.

Q. At about that time you suggested to Mr. Barrows that he submit to you a draft of what he had in mind, isn't that right?

A. That is correct.

Q. And at that time you were considering a contract involving the purchase of oyster shell by Westvaco from Pacific, and the sale of gypsum and lime by Westvaco to Pacific, is that right?

A. That's right. They were considering purchasing shells from us, and we were to buy lime and gypsum from them.

(Testimony of James H. Colton.)

Q. Then under date of September 18, 1936 you received a [1068] letter from Mr. Barrows, which is in evidence as Defendant's Exhibit H, did you (showing paper to witness)?

A. I think that is right. Without comparing it, I think that is right.

Q. Enclosed with that letter was a form of agreement which covered the draft of agreement providing for the purchase of oyster shell by Westvaco from Pacific and the sale of gypsum and lime by Westvaco to Pacific, is that right?

A. That is correct.

Q. And then did you have any further discussion with Mr. Barrows after this letter was received by you?

A. I think the only discussion Barrows and I had after that pertained to the specifications.

Q. But your recollection is that you did not have any further conversation with Mr. Barrows regarding any of the provisions of this transaction other than the specifications, isn't that correct?

A. I don't recall what we discussed other than the specifications.

Q. You don't even recall having any conversations with Mr. Barrows after September 18, 1936, do you?

A. I am sure he did talk to me after that time, but just how many times, I don't know.

Q. Do you recall now that you did have conversations with him?

A. Yes, I am sure we discussed the specifications after that. [1069]

(Testimony of James H. Colton.)

Q. Just the specifications?

A. I am sure we did that; I can't say what else.

Q. Did you discuss anything else?

A. I don't recall it.

Q. Do you recall that you had any conversation with Mr. Barrows other than the one relating to the specifications?

A. Oh, I had a number of conversations with him.

Q. You did?

A. At different times, but as to trying to fix the dates in my mind, I can't do it without reference to something else.

Q. Do you remember when your deposition was taken on October 24, 1947, and at page 19, line 24, I asked you these questions and you gave these answers:

“Q. Now, following the receipt of that letter, Mr. Colton, when was the next time that you met with Mr. Barrows for the purpose of discussing this contract?

A. Well, sir, I couldn't tell you whether I met with Barrows again—

Mr. Rosenberg: What is the answer?

(Answer read.)

The Witness: With reference to the contract.

Mr. Rosenberg: Q. You have no recollection of any meetings or discussions with Mr. Barrows subsequent to September 18th, 1936?

A. You are talking about verbal discussion now? Is that your question, whether I verbally discussed the contract [1070] with him afterwards?

(Testimony of James H. Colton.)

Q. Yes.

A. I can't name any time that I verbally discussed the contract with him afterwards.

Q. Now, did anyone else on behalf of Pacific carry on the negotiations toward— A. No.

Q. Let me finish the question, please.

A. All right.

Q. —toward the ultimate execution of the contract, other than yourself, after this date?

A. Not so far as any verbal conversations are concerned that I know of.

Q. Well, through what medium were the negotiations carried on from this point?

A. Then it is my belief that the outline of the contract which was presented with Mr. Barrows' letter was received by me, discussed with the other officials of your company"—

The Witness: "Our company."

Mr. Rosenberg: "Of our company," pardon me—"and certain paragraphs were marked to stay in the agreement as is, or as drawn; certain changes were to be made in a paragraph, or a paragraph was to be rewritten entirely; and the draft or agreement which Mr. Barrows sent to me was then sent to our attorneys for redraft. I can't be positive [1071] whether it went back to Barrows before it went to the attorneys or afterwards—I can't remember that, but the actual fact is that after it was redrafted—I am not positive that Barrows and I discussed it, because he went east, and I think Williams came up to see me once or twice,

(Testimony of James H. Colton.)

but it was in connection with signing the agreement rather than for a discussion of the terms or conditions or anything of that sort. It was relative to the final execution of the agreement.

Q. Now, the agreement is dated January 27th—" Then Mr. Kaapcke corrected me, "29th, isn't it?" and I say, "Yes, January 29th, 1937."

"Q. Between September 18th, 1936, and the date of the execution of the contract how were the negotiations between the companies carried on which resulted in the ultimate contract?

A. It seems to me I have just gone over that with you as near as I know how to do it.

Q. Well, you stated that you and your fellow officials of Pacific made certain recommendations with reference to the draft that had been presented by Barrows?

A. And we rewrote it and sent it back to the California Chemical Company either by letter or in person; I don't remember.

Q. When you say "we rewrote it," you mean your attorneys? [1072]

A. I mean our attorneys did.

Q. And then was the contract executed in the form that it had been rewritten by your attorneys, or were there further changes made?

A. I don't recall."

Mr. Bennett: Why don't you go on and read the next?

Mr. Rosenberg: I can read the whole thing.

Mr. Bennett: Well, I think that, having read that much, you ought to read the next.

(Testimony of James H. Colton.)

Mr. Rosenberg: (Reading):

“Q. You don’t recall?

A. There might have been some changes back and forth, but I don’t recall. My files didn’t show it, so I don’t know.

Q. And between September 18th, 1936—

A. You say September. I haven’t named September definitely. I said the latter part of 1936, in my opinion.

Q. Well, I am mentioning September 18th as being the date of Mr. Barrows’ letter to you.

A. Oh, that is it. All right.

Q. So between September 18th, 1936, and the date of the execution of the contract did you have any correspondence with Mr. Barrows or the California Chemical Company regarding the terms of this proposed agreement?

A. I had no correspondence with him that I recall.

Q. So your best recollection is that you took the draft [1073] prepared by Barrows, you and your fellow officers suggested modifications and submitted it to your attorneys and they redrafted the agreement and sent it to Barrows, and the agreement was signed in that form?

A. That is my opinion.”

Was that testimony correct? A. Correct.

Q. But you don’t have any recollection, do you, of any conversation with Mr. Barrows between September 18, 1936 and January 29, 1937?

A. No, I have no recollection of the time.

(Testimony of James H. Colton.)

Q. Let me ask you this, Mr. Colton—and I am referring now to the draft of agreement that is attached to Mr. Barrows' letter of September 18, and to the provisions of paragraph 6 of that draft, which states:

“6. The prices hereinabove stipulated to be paid by Pacific for gypsum, quicklime and hydrated lime are based upon the average direct cost to California to produce the materials covered by this agreement during the first year's operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California, and it is therefore understood and agreed that in the event of price advances and labor, transportation, fuel or supplies resulting in an increase of 5% or more in cost above the first year's average direct cost hereinabove referred to, [1074] f.o.b. cars shipping point, then and in that event California shall have the right to increase the price to Pacific to the extent of the increase above the said average direct production cost for lime or gypsum.”

You read that paragraph when you got that agreement, didn't you? A. Certainly.

Q. And you knew that that paragraph provided that the California Chemical Company would be entitled to a price increase only in the event and to the extent that their direct charges increased, did you? A. Yes.

Q. Now isn't it a fact that that paragraph was changed at the insistence of Mr. Barrows? You certainly didn't suggest any change in that paragraph, did you?

(Testimony of James H. Colton.)

A. That contract was changed by the attorneys in consultation with your attorneys, and I really don't know just how it was arrived at.

Q. You are certain that you did not suggest it?

A. I did not suggest it, no. My understanding was that it was going to stay that way. Until it was changed I did not know there was to be a change. I didn't discuss it with Mr. Barrows.

Q. But you certainly would not have suggested, Mr. Colton, that "direct charges" in the above language, you merely put in [1075] "cost of production" in the contract; you would never have suggested that?

A. I would have preferred to have it stay as it was, but still it might mean the same thing to an operating man, and does yet.

Q. What is that?

A. It still might mean the same thing to an operating man and does yet.

Q. At any rate, you are certain that that change in the contract was not made at your suggestion, was it? A. I didn't suggest it, no.

Mr. Rosenberg: No. That is all.

The Court: Step down.

Mr. Bennett: Just one more question. Counsel asked about a discussion. I think, your Honor, it might be well to call the witness' attention to a further portion of this deposition with reference to the discussion of specifications.

Redirect Examination

Mr. Bennett: Q. Turn to page 26, Mr. Colton, if you will, please.

(Testimony of James H. Colton.)

Mr. Rosenberg: What page?

Mr. Bennett: Page 26, line 10.

“Q. Now directing your attention to paragraph 5 of the contract, do you recall any specific discussion relating to the provisions of that paragraph? [1076]

“A. Yes, that paragraph was discussed at the time with Mr. Barrows, at the time I told him the specifications that we were going to ask for, and it was entirely satisfactory to him.

“Q. That is, the specifications?

“A. There was no argument on the specifications or argument on the fact that we were to either accept or reject, as set forth in this clause here. It was perfectly satisfactory to him. He thought he would have no trouble at all in meeting it, and didn't bother; he said his stuff was all going to run higher than 97.5 anyhow.”

That testimony was given by you at the time your deposition was taken?

Mr. Rosenberg: Just a moment. May I ask the purpose of that question? What does it have to do with the direct testimony?

Mr. Bennett: Simply this, counsel, and I think it is perfectly clear: The witness stated that after he received this draft of Mr. Barrows' letter of the 18th of September, he had a discussion with Mr. Barrows with reference to the specifications as provided for in this paragraph 5 or in relation to paragraph 5 of the Barrows' draft.

(Testimony of James H. Colton.)

Now, you read a portion of his deposition apparently for the purpose of negating the fact that the witness did have such discussion with Mr. Barrows. What I wanted to show is [1077] that in the deposition which you took of the witness, the witness stated at that time that he had this discussion with Mr. Barrows as to the specifications for the gypsum.

Mr. Rosenberg: And he doesn't say that it was after September 18, 1936.

Mr. Bennett: Oh, I think so, because, obviously, that is it. You handed him a document, this document that accompanied Mr. Barrows' letter of the 18th of September.

Mr. Rosenberg: Oh, no, Mr. Bennett, please, now; the document that I handed to this witness in the deposition is the contract that was ultimately executed, and I asked him about conversations that he had about paragraph 5, which is the paragraph relating to the specifications, moisture, credit for lower gypsum content; so you are just all tangled up, I think.

Mr. Bennett: No, I am not tangled up a bit, counsel. Paragraph 5—where is the Barrows draft?

Mr. Rosenberg: That's right; that is the agreement you have got there.

Mr. Bennett: You will see I am not tangled up.

Mr. Rosenberg: Show me anything about the specifications in that paragraph.

Mr. Bennett: Well, the specifications apparently do appear, your Honor, in this paragraph 5 of

(Testimony of James H. Colton.)

the main contract, that is, the contract that was finally executed. [1078]

The Court: I read it.

Mr. Bennett: My statement—

The Court: I just read it; I couldn't follow it.

Mr. Bennett: Yes, your Honor; and my statement that he was referring to paragraph 5 of the Barrows draft apparently is incorrect, but that is wholly immaterial. The point is that the witness was asked on his cross examination as to whether he had any discussions with Mr. Barrows with reference to specifications, and he did relate at the time his deposition was taken the discussions that he had with Mr. Barrows with reference to the specifications that appear in the contract.

Now, without taking the time to read the Barrows' draft through in full, I am not prepared to state all the specifications, if any, appeared in that contract.

Mr. Rosenberg: They don't.

Mr. Bennett: In that draft. And apparently counsel is right now in saying that there isn't anything in the 18th of September draft submitted by Mr. Barrows that had to do with specifications. But as I recall the witness' testimony on direct, he did state that after he received this draft, or some time in connection with it, he did have a discussion with Mr. Barrows about the specifications. And my sole purpose in reading this portion of the deposition was to show that at the time his

(Testimony of James H. Colton.)

deposition was taken, that was gone into and the witness was interrogated at some length with reference to that [1079] subject matter.

Mr. Rosenberg: Anything further?

Mr. Bennett: That is all.

Mr. Rosenberg: No further questions.

The Court: Step down.

We will take a recess.

(Recess.)

[1080]

Mr. Rosenberg: Do you want to put that in?

Mr. Bennett: I haven't looked at it yet. I can look at this—

Mr. Rosenberg: I would like the record to show, if the Court please—the other day when Mr. Melhase was on the stand, Mr. Bennett asked if he could bring in a report that was made on that test—I have turned the report over to Mr. Bennett.

And also you asked, Mr. Bennett, for the quantities of ethylene dibromide produced during the various periods in question. I have those figures. If you want them, they are available to you.

Mr. Bennett: May I have that sheet that you have here (document handed to Mr. Bennett).

FRANCIS P. FARQUHAR,
called as a witness on behalf of defendant; sworn.

The Clerk: Your name?

A. Francis P. Farquhar.

Direct Examination

Mr. Rosenberg: Q. Mr. Farquhar, what is your business or profession?

(Testimony of Francis P. Farquhar.)

A. I am a certified public accountant in public practice.

Q. And since when have you been a certified public accountant?

A. By examination in 1917; I believe my certificate is dated [1081] back in '18.

Q. Will you give us a brief outline of your accounting experience since the time that you became a C.P.A.?

A. At the time I became a C.P.A. I was a lieutenant in the United States Naval Reserve, what was then the pay corps, and was cost inspector for the Navy at the Union Iron Works, Bethlehem Shipbuilding Corporation. I had been in practice employed prior to that time. After having been relieved of active duty in the Navy I was employed in San Francisco with a firm of public accountants for about two years, and then in 1922 I opened my own office and have been in practice under my own name or with partners associated with me since that time continuously.

Q. And in the course of your practice as a certified public accountant, have you had occasion to inform yourself and has your practice related to manufacturing costs and accounting?

A. Yes, I have had a considerably varied accounting experience. In fact, in the earlier stages of my professional work I was engaged very largely in industrial accounting in Boston, and later in San Francisco, working under the late Clinton H. Scovell, who was one of the recognized leaders in

(Testimony of Francis P. Farquhar.)

industrial cost accounting, and had an association with C. V. Wellington, who is now the head of Scovell, Wellington & Company, in New York and other Eastern cities, and I felt that I was very well educated in the fundamentals of cost accounting through [1082] association with them, and later here in San Francisco. Since then I have had a varied practice.

Q. And do you have any affiliation at the present time with that firm?

A. Yes; ever since I opened my own office, I have represented Scovell, Wellington & Company on work for their clients on the Pacific Coast, and have done—occasionally we do the entire work under the name of Scovell, Wellington & Company, so we have a close continuous affiliation with that firm.

Q. And their business is primarily industrial accounting, is it?

A. It is a general accounting practice, but rather more predominantly industrial accounting than most of the other large firms.

Q. And what societies or institutions are you a member of?

A. I am a member of the American Institute of Accountants; I am a member of the California Society of Public Accountants—Certified Public Accountants, of which I have been president; and I have been a member of the National Association of Cost Accountants practically since its inception in 1920.

Q. Now, Mr. Farquhar, I am going to ask you to assume that a chemical plant is recovering from

(Testimony of Francis P. Farquhar.)

a common raw material three different products, which we will designate as products A, B, and C, and I will ask you to assume that product B is technically a by-product in the sense that it consists in part [1083] of a chemical element which must be extracted from the raw material in order to produce product C in a pure and salable form. Assume also that in order to convert part of B into a salable commercial product after it is separated from the raw material, it is necessary to process it, and that for that purpose it is necessary to have a physical plant devoted exclusively to such processing, and it is likewise necessary to employ labor which devotes itself exclusively to this processing. And assume further that by reason of contract it is necessary that the manufacturer determine the cost of production of product B. Will you state, in your opinion, whether under these circumstances it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead of the plant?

A. If overhead is what I consider the generally accepted definition, I would say that you cannot obtain true costs of any production without some portion of the overhead, because the line of distinction between direct costs and overhead is an artificial one, largely a practical matter; that costs must include all the elements that go into it, and one of the elements that goes into the production is the group of things that are generally classified as factory overhead.

(Testimony of Francis P. Farquhar.)

Q. And under the same assumed circumstances, will you state whether or not, in your opinion, it would be proper and good accounting practice to include in the cost of production of [1084] product B a portion of the indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products manufactured in the plant, including product B, but as to which it is impossible or impracticable to keep records of the time devoted exclusively to each particular product.

A. Well, it is the general nature of overhead that you cannot keep a minute and accurate account of it; that you have to use some devices for allocating it, and it exists; and therefore, to get sound costs, you must absorb that overhead in the various products. And I think that, as I understand, Product B is something that, as you call it a by-product, but if it takes any further processing it must carry—it must absorb in some proportion, depending entirely on the circumstances, all the elements of cost, which would include the items which you mention.

Q. Now, under the same assumed circumstances, would you say that any such charges which would continue even though the production of product B were discontinued, although in some lesser but unascertainable amount, should not be included in the cost of production of product B? A. No.

Q. In other words, is it your opinion that the fact that some charge which otherwise would be a

(Testimony of Francis P. Farquhar.)

proper charge to include in cost of production is not objectionable merely because it [1085] might continue in some lesser or unascertainable amount even though you discontinued the production of the particular product?

A. Well, if you discontinued the production of this particular product, you have to re-allocate these overhead charges; but that doesn't mean that you wouldn't include them as long as the product is being produced.

Q. In your opinion, Mr. Farquhar, and assuming without conceding, that product B is a by-product in the sense that I have mentioned, in your opinion, should any different accounting methods or principles be applied in determining the cost of production of that product than you would apply ordinarily in determining the cost of production of any one of a number of products produced in a single plant?

A. I think the theory is the same. The practical method of determining how much would vary with the circumstances, but the theory would hold in all cases.

Q. Now, under the same assumed circumstances, assume that you have a shipping compartment in this plant in which both products C and B are shipped, and that the direct labor employed in the shipment of each of these two products is determined by time card records, and is charged

(Testimony of Francis P. Farquhar.)

to each of the two products in accordance with the time card records, but that expense such as the expenses of a foreman, a foreman's assistant, a shipping clerk, demurrage and tractor expense [1086] in connection with the shipment of the two products in allocated and charged to the two products in the respective proportions that the tonnage of each product shipped bears to the total tonnage handled. Now, in your opinion, would that be good and proper accounting practice?

A. If I understand you correctly, you are talking now about charges, shipping charges that relate only to B and C; that do not relate to the main product; is that right?

Q. Well, let me inject A into the picture as well.

A. Well, it doesn't make any difference how many different products are there. There are besides the direct labor, which can be ascertained from time cards, or through a foreman's allocation on the spot at the time—it amounts to the same thing—besides those, there are certain elements of shipping expense—you mentioned, I think, the foreman, himself, or general superintendence of shipping—that have to be absorbed in the cost of shipping all of the products; and the method of ascertaining how much to each, is one that requires a study on the spot of the circumstances.

There are various ways of doing it, one of which is what you stated, on a tonnage basis, which frequently, is a sounder method than to do it on a

(Testimony of Francis P. Farquhar.)

basis of adding up the other costs or the labor time. It could conceivably be one of the others; it could very properly be allocated on and measured by the volume or weight of materials handled.

Q. And under your hypotheses would you say that it would be improper to allocate any of these expenses, shipping expenses, to product B merely by virtue of the fact that you designate Product B as being a by-product?

A. Well, the designation "by-product" seems to be more or less of an agreed term. It is what it really is that counts. If this product has reached any considerable volume, and especially if separate and distinct operations are applied to it, it becomes, whether you call it a by-product or not, something definite of itself, and there it is; and if labor or expense is applied in transforming it or moving it, that is part of the cost of it.

Q. Will you tell us this: Whether or not in accordance with good and accepted accounting practice, it is customary to include plant overhead in cost of production of a manufactured product?

A. Well, you can find all stages of accounting practice in cost accounting. There has been a great deal of progress and development in it in recent years, and I think the tendency is to more and more specifically allocate all kinds of costs, either through a machine hour rate, or through a process rate which will gather together in one factor all of these various expenses. Therefore, I will say that it is—anything that tends to absorb in their actual

(Testimony of Francis P. Farquhar.)

incidence all elements of cost is good accounting practice. [1088]

Q. On what do you base these opinions, Mr. Farquhar?

A. Well, I base them on actual work, in devising cost methods and in familiarity with the practice in our office and in the office of our associates.

We get their reports frequently, particularly if there is any new development or modern up-to-date job on installation accounting, our office is furnished with a report. I read and digest those, discuss them with my partner. I have in front of me constantly, right in front of my desk, the entire file of the bulletins of the National Association of Cost Accountants, and have watched with a great deal of interest the improvement in cost procedure that is shown through those bulletins. Those are bulletins that come out twice a month, and have since 1920.

There are many books on the subject. One of the earlier ones that I was familiar with when I was in the East with Scovell, Wellington was the *Burden Methods*, by A. Hamilton Church, whom I have always regarded as one of the leaders in sound cost accounting methods, and I have followed and read his subsequent publications.

To go back quite a way, in the time I was in the Navy, I dealt specifically with the decisions on cost matters. I don't recall that the problem that we are discussing here was any specific problem at that time, but I had general familiarity with indus-

(Testimony of Francis P. Farquhar.)

trial accounting and acted as what you might [1089] call the court of first instance in deciding what went into costs. Later I prepared a Manual of Cost Accounting for the Navy Department, which dealt with costs.

I have always taken a great interest in the theory of cost accounting, and I think it is through this continued interest and with the accumulation of practice over thirty years that I visualize cost accounting as something that absorbs the costs; and the problem is each time a different one in a factory, but the theories and principles are constant.

Mr. Rosenberg: No further questions.

Cross Examination

Mr. Bennett: Q. Mr. Farquhar, have you ever had experience in your lifetime of setting up or observing a system of cost accounting applicable to a by-product where there was contract between the buyer and the seller, where the buyer's price was determined or affected by any actual increase in costs between two comparative periods?

A. I can't recall any case precisely of that character, but I can say that I have had a part in setting up a method of cost accounting where the price was based upon the cost, and we had to departmentalize the costs, because there were different products; but in that case the entire output was subject to a somewhat similar contractual—

Q. There was no question there, then, of what costs should be allocated and what a cost should be as to any specific [1090] product of that plant?

(Testimony of Francis P. Farquhar.)

A. Well, we had to allocate them in order to get the respective costs of the different products.

Q. But of the whole total of the thing, it didn't make any particular difference so far as the purchaser was concerned as to how those costs were allocated, did it?

A. Well, I would have to develop that considerable to answer that question off-hand. I have in mind the allocation of costs of the construction of a plant where the construction of the plant, itself, was a cost-plus job, and it was of considerable importance to determine the cost of construction of each separate department of that plant, because the costs of the various products would vary considerably with the burden rate on each department. That was a mining company, mining chemicals. So I think, while I was not engaged directly in the determination of the cost of the product, itself, indirectly I was in allocating the overhead of the contractor's office to the departments. I think it is an analogous case.

Q. That was an ordinary cost-plus profit construction case?

A. That is right, but the point was not the cost—the payment to the contractor, but the setting up of accounts so that the manufacturer could use them afterwards.

Q. So that he could for the different parts of his plant determine the amount of the cost that that particular plant should bear in its total cost of construction, is that correct? [1091]

(Testimony of Francis P. Farquhar.)

A. Yes; it was important to know the difference between a liquid or a powdered material.

Q. Do I understand you to say that you do not draw any distinction at all in cost accounting, in the determination of the cost of manufacture of the by-product than you would in the case of a co-product or primary product?

A. In theory, no. In practice, frequently.

Q. As a matter of fact, in most instances of typical by-product manufacture, the manufacturer simply credits against the cost of the production of the main product the sales received from the by-product, isn't that correct?

A. It may be in some instances. I wouldn't say that that is sound theory.

Q. Well, isn't it the more general practice in handling the matter of cost accounting for by-products?

A. Only where the cost of—the expense of separating those costs is out of proportion to the results. If the by-product, as it is called, is of any considerable magnitude, I think you wouldn't get sound costs if you didn't set up separate accounting.

Q. Well, you are speaking of theory on the one hand, and I was speaking of the usual practice on the other. I will ask you if it isn't a fact that in determining the cost of a manufactured by-product that they only start figuring the cost at [1092] the point of separation from the material going into the main product?

(Testimony of Francis P. Farquhar.)

A. That is frequently the case, but not always. Sometimes it is possible to determine costs further back.

Q. That would be, according to what experience you have had, the more usual or customary method followed in by-product cost accounting, would it not?

A. Well, in the sense that perhaps the best application of theory is rarely found, and that frequently the other method is satisfactory for the purposes of manufacture. I think where it is only for the purposes of the manufacturer I could think of more instances where they did not refine the costs than where they do.

Q. Now, in the case of determining the cost of a co-product or a joint product, they start the matter of costs including processing costs back at the beginning of the operation, do they not?

A. Where it is possible.

Q. Now, where a manufacturer starts the charging of costs or the allocating of costs only after the point of separation, that would indicate, would it not, that that manufacturer is treating that product as a by-product?

Mr. Rosenberg: Just a moment. I will object to that on the ground that it is incompetent, irrelevant, and immaterial, and argumentative. [1093]

Mr. Bennett: This is cross-examination. I think it is highly material, your Honor.

The Court: Read the question, Mr. Reporter.

(The reporter read the question.)

(Testimony of Francis P. Farquhar.)

The Court: You may answer.

A. Well, I don't think that that is the test of a by-product. There might be considerably difficulty in some processes in determining that cost at an earlier stage, but that doesn't change the theory that if it is possible to allocate costs they should be allocated at as early a stage as they can be done where it is a practical matter to do so.

Q. Take the case of these three products that counsel for the defendant mentions, products A, B, and C, all of which result from or are made from a base material which we will call, say, seawater, or a condensed form of seawater, as the initial raw product. Now, if you are setting up a system of cost accounting and treat those products as joint or co-products, they would start bearing the share of the cost of the operations at that plant from the beginning, would they not, Mr. Farquhar?

A. If it is practical to ascertain them. [1094]

Q. Now, if, on the other hand, one of those products, let us say product B, was a byproduct which came off in the course of the process of manufacturing, say, the end products C, and that required some further processing, and if B was in fact, a byproduct, then in the usual case as the practice is employed in industrial firms, the charges would start—the costs would start at the point of separation in the case of a by-product, would it not?

A. Well, I am afraid I fail to get the distinction between a by-product and a co-product where this

(Testimony of Francis P. Farquhar.)

by-product has so much done to it after the point of separation; the distinction between a by-product and co-product seems to me not quite clear. A by-product as described here—the so-called by-product—appears to have a further process by which another product comes out of it, and that seems to me to be getting pretty far away from the customary definition of a by-product, which—

Q. Well, in this case, then, which you are speaking of, you say the situation involved here, you would go back and pick up and charge against the so-called by-product at the very start of the manufacturing process, would you not?

A. If it is possible. I don't know enough about the physical layout or the character of this particular substance to know whether there is a means of measuring earlier, that is—

Q. Take the case of a peach canner who buys peaches and his primary product is the canning of peaches. As part of that [1095] operation he has to remove the pits in order to cut and slice and can the peaches. Those pits, assume them to be wholly valueless, valueless waste, unless they were ground up and formed into a briquet; that further processing involved the grinding of the peach pits into an outer or granular form and the pressing of these bits into the briquets. Now, would you consider that a by-product or a co-product?

A. Well, there is very little distinction.

Q. Well, you mean that you wouldn't designate it either a by-product or a co-product; you would

(Testimony of Francis P. Farquhar.)

treat it just the same as you would a co-product for accounting purposes?

A. It all depends on the volume and the proportion. The only distinction between a by-product and a co-product is one of proportion.

Q. Well, let us consider that—

The Court: Pardon me. What do you mean by “proportion”?

A. Well, if the so-called—if the product is of very minor consequence, that seems to me to justify the use of the term by-product. But if it involves any considerable amount of handling or reprocessing, I would call it a co-product.

Mr. Bennett: Q. Well, I have outlined the process that is involved in the case of the peach pits and let us assume further that the—

A. I think that the peach pit would ordinarily be called a by-product. [1096]

Q. Let us assume the peach pit weighs approximately the same as the peach, itself, and that the finished briquet of the peach pits sells for approximately one-ninth or one-tenth that the peaches do in the cans after they are canned. Would you still consider that as a by-product?

A. Yes, I think it ordinarily would be called a by-product.

Q. A by-product? A. Yes.

Q. When would you pick up the cost of processing of the by-product? Would you pick it up at and after the time the peach pit was removed from the peach, or would you pick it up beginning when

(Testimony of Francis P. Farquhar.)

the peaches were delivered to the cannery by the farmer?

A. Well, if I were installing an accounting system, I think my first inquiry would be if there is any value to the peach pit before it is processed.

Q. I told you, Mr. Farquhar, it had no value; it would be a valueless waste unless it was further processed by grinding it and pressing it, and forming it into a briquet. On that supposition, and with the further matters, the relative weight and value that I have gotten you, would you still consider that a by-product?

A. Well, I think that I should complete my statement there, which is really an answer to your question, that if an adjoining manufacturer were willing to buy those pits even for a very inconsiderable or minute sum in order to re-process them, then [1097] that would give an opportunity for measuring the material cost of the by-product; but if, as you say, they were—nobody would offer for it, then there is no assignable value to the material, itself.

Q. And you would start your cost accounting at the point of separation of the peach pits from the pits? [1097-a]

A. If it is true that there is no means of determining a relative portion of the value of the material, then I would start the cost accounting for the by-product in the processing of the peach pit.

Q. In that sort of a situation would you assign to the cost of the by-product the plant overhead, a share of the entire overhead of the plant?

(Testimony of Francis P. Farquhar.)

A. In so far as it can be allocated to a separate process, if separate process goes on, it immediately picks up some portion of the plant overhead.

Q. I am stating a situation where there are only two products produced at this cannery: one is canned peaches and one is the briquettes, and assuming also in the manufacturing of these briquettes from the peach pits, the labor involved in the drying and grinding and forming them into the briquettes would take foremen and the canning operation in canning peaches, direct labor would involve 32 men: would you also consider in adding to the cost of manufacturing the briquettes, in addition the direct cost of the labor and such materials as went into that, depreciation on the machines and part of the plant that were used for making briquettes, taxes and insurance, also a portion of the entire plant overhead on the basis, say, that the direct labor involved in the manufacture of the by-product briquettes or to the direct labor involved in canning peaches?

A. I don't think direct labor is necessarily the sound measure [1098] of allocating overhead.

Q. Why not?

A. Because there are many cases where the direct labor would not be the entire measure at all.

Q. In other words, there might be a wholly disproportionate quantum of labor either in the manufacture of the by-product or the manufacture of the primary product?

(Testimony of Francis P. Farquhar.)

A. The by-product might actually absorb a greater proportion of the overhead due to other circumstances than if you measured it by direct labor cost.

Q. So you would say as an abstract proposition in allocating these overhead costs in the case of by-products that the direct labor basis would not be a suitable method of allocating?

A. No, I didn't say that. I said it might be or it might not be, depending on the circumstances. I am inclined to use a process factory in which you assemble the various costs into a factor process rather than proportion it by direct labor cost.

Mr. Rosenberg: Just a minute. You asked a question that you did not permit the witness to answer under your hypothetical set of circumstances as to whether he would charge that—

The Witness: Yes, I would charge that—

Mr. Bennett: The witness answered that question, counsel, and I asked the final question as to whether he would allocate it on this labor basis and he said he would not.

The Witness: No, I said in some cases I would and in [1099] some cases I would not.

Q. The hypothetical case I gave you was that in which the by-product processing from point of separation required foremen. The other direct labor involved in the manufacture of primary product, canned peaches, involved 32 men, and I gave you the relative weights of these products and their relative values. Now, I ask you whether you con-

(Testimony of Francis P. Farquhar.)

sider it a sound basis of cost accounting to allocate to the plant overhead the indirect items on that ratio of labor to labor, direct labor to labor.

A. That would be a sound basis, but it might be that because of the greater amount of costly machinery involved in one process or the other, that that would greatly outweigh the labor factor in determining the allocation.

Q. Such a method of allocation, without going into the refinements which you have made, might well produce a determination of cost which would reflect the actual costs, wouldn't it?

A. It could, yes, and if you did it strictly on a number of laborers, that might or might not reflect true cost. There are other ways I would consider more reliable.

Q. When we deal with the direct cost in an operation of that kind, we can determine without any trouble under, perhaps, several methods of accounting the actual direct costs that go into that product, can't we? A. Yes.

Q. In, for example, this hypothetical case, the briquettes [1100] made from peach pits, by determining the salary or wages or labor that is actually employed in the further processing of those peach pits, the light and power, the fuel and such materials that go into that particular product, we can determine with exactitude precisely the amount of the direct cost involved.

A. With reasonable accuracy, yes.

Q. When we get into this matter of allocating

(Testimony of Francis P. Farquhar.)

the costs on this situation I mentioned on the labor basis, we get at best an estimate of cost, don't we?

A. Yes, all allocations of indirect cost are at best an estimate.

Q. At best an estimate? A. That's right.

Q. And they do not necessarily reflect or reveal as contra-distinguished from the situation of direct cost the actual costs involved?

A. With this qualification, that all of the indirect costs have to be absorbed some way.

Q. Yes. Well, so far as the manufacturer himself is concerned, if he alone is concerned with the matter of cost accounting of a plant where, perhaps, three products are being produced or forty products are being produced, and as you say, we strive to allocate against every one of those products some part of the overhead and indirect charges, the plant overhead [1101] burden and it involves, as you say, an estimate in each case. A. An estimate is not a guess.

Q. Well, it is something different from an exact determination, isn't it?

A. I don't think any cost accounting can be considered exact, but it can be fairly reliable.

Q. Of course, you concede, do you not, that in determining direct costs you can determine those with greater exactness than you can the allocation of indirect? A. Yes.

Q. The minute you get into allocating costs you inject the element of estimate and to a certain extent, conjecture, do you not?

(Testimony of Francis P. Farquhar.)

A. You can greatly refine that, and the more you analyze the nearer you come to a sound and reliable basis.

Q. Well, now, going back for just a moment, Mr. Farquhar, to this hypothetical situation in the manufacture of peach pits, I asked you whether you considered that the allocation of the overhead to this by-product on the basis of direct labor charges was proper and you said, "I could not say that without further determining whether that was a proper relation." A. That's right.

Q. So you would not have this Court understand that in any number of given situations that it is equally appropriate to make allocations of overhead on a direct labor basis, would you? [1102]

A. If I understand you correctly, it is not the sole method nor always the best. In some instances it might be right and in some instances it might not be very far from a sound basis.

Q. In some instances it might involve as to the whole matter of the overhead a reasonably approximate estimate of the allocations, and in another case it might involve an estimate that was far from the facts of exactness, isn't that so?

A. Yes.

Q. In other words, you consider that you have to determine these relative factors something beyond the mere relation of the direct labor involved in the by-product and the indirect labor involved in the main product?

A. In modern cost accounting direct labor is rarely used as the basis of allocation where there

(Testimony of Francis P. Farquhar.)

is a considerable amount of physical plant involved. May I illustrate that? I don't know that it is pertinent——

The Court: You may.

Mr. Bennett: Go ahead.

The Witness: In two adjoining processes, one, we will say, in casting, a considerable amount of the cost is labor and supervision of labor; while in an adjoining machine shop with an automatic machine there may be very few men. Now, to say, because in the machine shop there were only a few men while in the foundry there were many men, that you should allocate by the number of laborers or the payroll, obviously it would [1103] not be a sound method of allocation. Every individual case of processing has to be studied. I have actually been on my hands and knees through factories determining a square foot factor, which is one way of doing it.

Q. And in the case you mentioned, to apply this direct labor basis of allocation in the hypothetical situation, isn't it true that you have loaded on one product, either the primary product or the by-product a share of overhead which is wholly disproportionate to the actual cost to the manufacturer of that product?

A. In the extreme case I cite, if you did it by labor, it would disproportionate it.

Q. Yes. Now, Mr. Farquhar, in these items that you would allocate, how far would you go? You would limit them to the actual allocation of plant overhead, would you not?

(Testimony of Francis P. Farquhar.)

A. Everything that relates to the production of the product.

Q. Things that don't relate to the production of the product would not be allocated to it?

A. Not to the production cost, but there are other costs that follow on distribution.

Q. Yes, you have legal costs, you have general administrative cost, but you would not allocate them as costs of production on a product, would you?

A. Yes, in many factories the general administration deals almost entirely with production and when selling itself is [1104] automatic.

Q. What is that?

A. The product sells itself automatically and most of the administration deals with production.

Q. How far up do you go? Do you allocate all the way up to, say, an office that may be in Paris or London, England, the overhead of home office administration in determining the actual cost to manufacture?

A. It could be if that Paris office were engaged in the purchase of materials for dressmaking.

Q. That would be for the reason that it had a direct relation to the manufacturing of that product?

A. Yes.

Q. But generally, in determining the cost of actual manufacture, they differentiate between what we call purely administrative costs and manufacturing costs, don't they?

A. I think there are a great many instances

(Testimony of Francis P. Farquhar.)

where you could not make that flat statement. The test is in cost accounting to absorb as much cost as possible into the various steps of the production and distribution of the article.

Q. That would include sales costs and everything else?

A. The selling expense can be apportioned between different types of articles, but a selling expense is not a cost of production.

Q. We are talking about cost of production.

A. Well, cost of production may have a considerable share of the administrative expense where selling is very little. Going back to my Navy experience, there was no selling expense after the contracts, and all the administrative expense was apportioned as overhead and acknowledged as overhead and paid for by the United States Government, the Navy Department, as part of the cost of building destroyers. There was just a minute amount left for selling.

Q. Suppose in a plant they have a certain amount of overhead that has to do with something wholly dissociated from the manufacture of a particular product that you assign as a part of the cost of the product or allocate a part of the cost of that product or portion of that particular item for overhead——

A. If it is dissociated, no.

Q. Supposing this peach cannery that I mentioned to you a while ago has suddenly decided it wanted to do some research in canning string beans

(Testimony of Francis P. Farquhar.)

and set up a research department, scientists, and desks and other things; would you allocate a portion of that to the cost of manufacturing a by-product, briquettes and peach pits.

Mr. Rosenberg: Just a moment. I object to that on the ground there is no conceivable foundation for that.

The Court: We are going far afield and into considerable romancing on this. I say that advisedly, counsel. With that in mind, proceed. [1106]

Mr. Bennett: If Your Honor feels that way, obviously I will not go any further.

That is all, Mr. Farquhar.

Mr. Rosenberg: That's all.

The Court: We will adjourn until tomorrow morning at 10:00 o'clock.

(Whereupon an adjournment was taken until 10:00 o'clock tomorrow morning, Wednesday, December 31, 1947.)

CERTIFICATE OF REPORTER

We, Official Reporters and Official Reporters pro tem Certify that the foregoing transcript of Record pages is a true and correct transcript of the matter therein contained as reported by us and thereafter reduced to typewriting, to the best of our ability.

/s/ JOSEPH J. SWEENEY. [1106-a]

Wednesday, December 31, 1947, 10:00 o'clock a.m.

The Clerk: Pacific Portland Cement Company v. Westvaco.

GEORGE A. MAXWELL

called as a witness on behalf of the defendant, being first duly sworn, testified as follows:

Q. (The Clerk): Will you state your name?

A. George A. Maxwell.

Direct Examination

Q. (Mr. Rosenberg): Mr. Maxwell, what is your business or profession?

A. Certified public accountant in practice.

Q. Since when have you been a certified public accountant?

A. Since about 1921.

Q. Are you affiliated with any firm?

A. I am a resident manager of Barrow-Wade-Guthrie & Company, a national firm.

Q. That is a national firm of certified public accountants?

A. Yes.

Q. Where do they have offices, Mr. Maxwell?

A. The principal office is in New York City, and other offices are throughout the country: Chicago, Boston, Philadelphia, Los Angeles, San Francisco, Seattle and Canada; correspondents abroad.

Q. Will you give us an outline of your experience in accounting since you have been a certified public accountant?

A. Since I have been a certified public accountant, and before that, I practiced professionally with the emphasis on industrial accounting, cost systems, their installations, the determination of costs for various purposes—for example, in the settlement of cost-plus contracts with the government

(Testimony of George A. Maxwell.)

and generally, accounting practice with the emphasis on industrial accounting.

Q. Are you a member of any accounting societies or institutes?

A. Yes, I am; a CPA of California and also of Maryland and the State of New Hampshire. I am a member of the American Institute of Accountants. I am a member of the National Association of Cost Accountants. I am a member of the Society of Industrial Engineers and was a member of the Controllers Institute of America.

Q. In your experience the emphasis has been on industrial and cost accounting, is that correct?

A. Yes.

Q. Mr. Maxwell, I will ask you to assume a chemical plant in which from a common raw material three different products are recovered——

A. Yes.

Q. ——which I will refer to as products A, B and C, and I will ask you to assume that product B is technically a by-product in [1108] the sense that it consists in part of a chemical element which must be extracted from the raw material in order to produce product C in a pure and salable form. Assume that in order to convert product B into a salable chemical product after it is separated from the raw material, it is necessary to process it, and for the purpose of such processing it is necessary to have a physical plant devoted exclusively to such processing, and it is likewise necessary to employ labor which devotes itself exclusively to the process-

(Testimony of George A. Maxwell.)

ing of this material or this product in order to convert it into a merchantable and marketable product; and assume further that by reason of a contract it is necessary that the producer of this product B determine the cost of production or cost of manufacture of that product: Under those circumstances will you state whether or not in your opinion it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead and expense of the plant?

A. Oh, yes, certainly; and that is the consensus of opinion of authorities.

Mr. Bennett: Now, I move to strike out, if Your Honor please, the volunteer statement of the witness that that is the consensus of opinion of the authorities.

Mr. Rosenberg: I submit that is responsive.

Mrs. Bennett: It is egotism in the extreme and it is not proper testimony. [1109]

The Court: I consider it proper testimony. You may examine him on his knowledge of the authorities. Let the question and answer stand.

Q. (Mr. Rosenberg): Mr. Maxwell, under the same assumed circumstances, would it be proper and in accordance with good accounting practice to include in the cost of production of this product B a portion of the indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products, including product B, but as to which it is impossible or impractical to keep

(Testimony of George A. Maxwell.)

records of the accurate time devoted exclusively to each particular product?

A. Yes, definitely. When you refer to overhead expenses, the reason they are overhead is because they can not be definitely allocated to a product at the inception of the expenditure, and therefore they must be scientifically distributed over all products that share in whatever service for which the expense is incurred.

Q. Is there any reason in your opinion and based upon your experience, why such charges should not be included in determining the cost of production of this product B, which I have described?

A. They should be included. Its prorata should be included in the cost of product B.

Q. Under the same assumed circumstances, will you tell me in [1110] your opinion as an expert whether any such charges which would continue even though the production of product B were discontinued, although in some lesser but unascertainable amount, should be excluded in the cost of production B merely by virtue of the fact that they can not be determined with exactitude?

A. The discontinuance of a product does not alter the fact that while the product is being produced, it should take its prorata share of overhead. The same situation arises with respect to what you might call a primary product. If a primary product is discontinued, it would necessarily follow that the overhead expenses, some of them,

(Testimony of George A. Maxwell.)

would continue, such as general management, insurance, taxes, depreciation, plant maintenance, and so forth, which would necessarily have to be distributed over the remaining products which were being continued in production, so that the effect of a discontinuance of a primary product or a by-product or so-called by-product would probably load a larger charge on the remaining products, once there was an increase in the production of those products. But the fact of a discontinuance of a product has no bearing on the necessity to prorate the manufacturing overhead expenses.

Q. Under the same assumed circumstances, will you assume that in this plant there is a shipping department maintained from which these products A, B and C are shipped, and that the direct labor employed in the shipment of the respective products, [1111] as determined by time card records, is charged to each of the products, and that other expense, such as foremen, foremen's assistant, shipping clerk, demurrage, tractor expense in connection with the shipment of the several products is allocated and charged to the three products in the respective proportions that the tonnage of each product shipped bears to the total tonnage handled: in those circumstances, in your opinion, would that be a good and proper accounting practice?

A. Yes, in a general way that would be proper accounting. All products that are shipped and which utilize the services of the shipping department, should bear its prorata of the cost of operat-

(Testimony of George A. Maxwell.)

ing that department. Otherwise that department would be rendering a gratuitous service. However, there is a factual aspect in it and that is the cost of shipping, whether it is a waste product, a co-product, a by-product or a primary product. All should bear this proportion of the cost of that service. Any other conclusion would be illogical.

Q. Mr. Maxwell, will you state whether or not in the case of a so-called by-product such as I have described, where it requires processing, physical plant and labor to be directly employed in making it a marketable product, whether, in your opinion, any different accounting method should be employed in determining the cost of such a product than would be employed generally in determining the cost of a primary product or the cost of a number of co-products produced in a single plant. [1112]

A. In my opinion, there is really no room in the nomenclature of industrial accounting for the word by-products. If a plant in conversational language, for example produces 40 products and 5 which are ordinarily referred to as by-products, to the accountant it does not produce 40 products and 5 by-products, but it produces 45 products, and the total expenditures of the concern, of the plant, of the organization should be absorbed by all 45 products, and the object of cost accounting is to find the most realistic basis upon which to prorate those costs in the aggregate, and those costs, some of them are direct and can be specifically and with precision allocated to each product. That is generally referred

(Testimony of George A. Maxwell.)

to as the direct labor cost or the direct material cost. Then there are other costs, a long list of costs, which can not be so allocated. It would be a physical impossibility to do so.

I might illustrate that by taking the salary of the general superintendent of the plant. During the course of a day he probably visits every department in the plant or maybe some departments he does not visit in the course of a week and it would be a physical impossibility for that superintendent, for example, to docket the places he visits from day to day, from week to week and from month to month, and that would be essential if you were going to have a mathematically accurate allocation of his salary to cost of products.

However, since that is impracticable, and as a matter of fact it was never attempted, then some realistic scientific basis which is pure estimate must be found, whereby you distribute that superintendent's salary; and particularly, if there were five or six thousand products, it should be obvious how impossible it would be; and the same applies to insurance, maintenance, repair work, taxes, and the whole gamut of expenses comprehended in the management of the plant.

Q. Will you tell us, Mr. Maxwell, on what you base the opinion you have just expressed?

A. I base these opinions on over thirty years' experience in professional accounting, and also from my studies I have had to read most of the literature on the subject in order to take my examinations.

(Testimony of George A. Maxwell.)

Q. Can you refer us to any comparable situations that you have run across in the course of your experience? A. Oh, yes, many.

Q. In which so-called by-product accounting has been handled in the manner you have mentioned?

A. Oh, yes, many. You find in very, very small industries where there is no attempt to have scientific accounting, that they use loose methods. Then, as you go up the scale, until you arrive at large industries, where management must have mathematically accurate data with which to manage the plant and guide its affairs, their accounts are maintained by [1114] thoroughly trained industrial engineers and accountants, and of course in that bracket you find all the recognized principles of good accounting are observed.

Q. What type of industry, for instance, have you had experience with where products comparable to the one that I have mentioned have been fully accounted for in the cost accounting, including overhead expense and indirect charges?

A. I could mention the chemical industry, automobile industry, airplane industry, textile industry, machine shops, and quite a general cross section of industry. I have had practical experience in all of them, and I have made cost installations in many of them.

Q. Are these opinions you have expressed some new opinions that you have developed for the purpose of this case, or are they opinions that you have held for some period of time?

(Testimony of George A. Maxwell.)

A. For many years. Of course, there is some development in cost accounting, but there has been no change in the definition of what constitutes cost. There have been changes in the methods of applying the definition in specific cases. For example, I think that it is quite unanimous among all accountants that cost of production, as it is defined in the regulations of the Treasury Department for the Federal Government Income Tax Law says, and it makes no distinction between by-products and the primary products.

Mr. Bennett: Now, just a moment, your Honor, this is not [1115] the best evidence. If we are going to have what the Federal Treasury Regulations are or what they provide, let us have them and not have this witness' testimony on that.

The Court: Just keep in mind that this witness comes on as an expert witness.

Mr. Bennett: But he is doing what the law does not permit. The law does not permit a witness on direct examination to quote some book or to quote some document. Now, the best evidence rule is, and I can cite your Honor authorities——

Mr. Rosenberg: May I shorten up this, if the Court please? There is no question on that point. There is a Civil Code section that provides when an expert witness is on direct examination he is not only permitted to express his opinions, but he is permitted to state the reasons for the opinions that he expresses. That is the Code of Civil Procedure, Section 1872, which says, "Whenever an

(Testimony of George A. Maxwell.)

expert witness gives his opinion he may, upon direct examination, be asked to state the reasons for such opinions, and may be fully cross-examined thereon by opposing counsel.

The Court: That is my understanding.

Mr. Bennett: Yes, your Honor, that means he can state his reason, but he cannot say that a certain book says, or what some other authority or alleged authority believes. Let me call your Honor's attention to what McBane says:

"On direct examination an expert witness may not [1116] incorporate into his testimony extracts from the writings of standard authorities in the field in which he is giving opinion evidence."

The reason for the rule is obvious.

The Court: Just a moment. Isn't the witness giving his reasons?

Mr. Bennett: But he cannot give the rules of the Treasury Department.

The Court: Read that again.

Mr. Bennett: It says:

"On direct examination an expert witness may not incorporate into his testimony extracts from the writings of standard authorities in the field in which he is giving opinion evidence."

The Court: There is an absence of that here. Proceed.

Mr. Rosenberg: He is merely stating what the law is.

(Testimony of George A. Maxwell.)

Mr. Bennett: I move to strike that portion of the witness' testimony which has to do with what the Federal Regulations provide.

The Court: In the interest of time I will omit that.

Mr. Bennett: Does your Honor strike that portion of the answer?

The Court: It may go out.

Q. (Mr. Rosenberg): Just let me ask you this one further question: You are prepared, are you, Mr. Maxwell, to provide [1117] authorities for the opinions that would sustain the opinions that you have expressed? A. Oh, yes.

Q. What do those authorities consist of?

A. Those authorities would consist of writers of standard texts who are in practice as industrial engineers and accountants, and most of whom are professors in the universities of the country.

For example, Eric Camman published a book entitled, "Basic Standard Costs." Eric Camman is a senior partner in the firm of Peat, Marwick, Mitchell & Company.

Mr. Bennett: I am sorry to interrupt, but my objection goes to this line of testimony. I object to the question and move to strike the answer on the same grounds that I stated in my previous objection.

The Court: Let the question and answer stand. Proceed, reframe your question.

Mr. Rosenberg: He was in the process of answering the question, your Honor.

(Testimony of George A. Maxwell.)

The Court: All right, what other authorities?

A. (The Witness): Another authority is Specthrie, a professor at Northwestern University and an industrial engineer wrote "Industrial Accounting." Another authority is Samuel Sanders, who is a professor of industrial accounting at Harvard. His book is also called "Industrial Accounting." Then [1118] there is Lawrence, whose book is called "Cost Accounting." Then there is a work by Newlove and Pratt, called, "Specialized Accounting." Both Newlove and Pratt are industrial engineers, and recognized as authorities in cost accounting. Then, of course, there is the Handbook of Cost Accounting Methods. It is a compendium of the writings of many authorities, consisting of approximately 2000 pages. That is regarded as a very authoritative work for industrial engineers and accountants.

Q. (By Mr. Rosenberg): Let me ask you this, Mr. Maxwell: I asked you whether these opinions that you have expressed are opinions that you have held for some period of time. Have you written anything on this subject that would corroborate the opinions that you have expressed from the witness stand today?

A. Yes, several years ago I wrote a little treatise on "Cost Control For Wineries," which was published by Prentiss-Hall.

Q. In that work did you also express the view that in accounting having so-called by-products, all elements for cost accounting, including overhead, should be included?

(Testimony of George A. Maxwell.)

A. Oh, yes, definitely.

Mr. Rosenberg: That's all.

Cross-Examination

Q. (Mr. Bennett): As I understand it, you treat by-products in determining the cost of manufacture identically as you would [1119] the main or primary products, would you?

A. Yes, and particularly if there was additional processing after the split-off point. In fact, authorities do not speak of it as a by-product. They speak of it as a co-product.

Mr. Bennett: I move to strike that part of the witness' answer that the authorities do not speak of it as a by-product, but speak of it as a co-product. as not being responsive to my question, and a volunteer and prejudicial statement.

The Court: The question and answer may stand. Objection is overruled. Proceed.

Q. (Mr. Bennett): Well, you would treat, then, a by-product that requires any further processing to make it salable, when it comes off the material that is used for the main or primary product as a valueless waste, you would treat that so far as accounting purposes are concerned as you would any co-product? A. Precisely.

Q. You make no difference at all?

A. None, whatsoever, in the method of accounting.

Q. In the case of the lumber mill that necessarily has to produce some sawdust as a result of its sawing operations, and that sawdust at the time

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and place is valueless unless something is done to it, the sawmill needs additional machinery or equipment to mold that sawdust into little briquets and sells the briquets; you would consider the briquets, so far as cost accounting is concerned, just as you would the boards of lumber [1120] that come out of the mill? A. Precisely.

Q. And you would allocate to those briquets a portion of the complete overhead, that is, the cost of the logs in the woods?

Mr. Rosenberg: Just a minute, we were talking about overhead. Now you are talking about cost of material.

Mr. Bennett: Well, all right, but I think I am entitled to ask that question.

The Court: Stay out of the woods for the moment.

Mr. Bennett: All right, I will get out of the woods and into the plant. However, with your Honor's dispensation, I am coming back to the woods literally for just a moment.

Q. All of the overhead of that plant, the superintendence, the accounting, the various and sundry and so-called indirect items, you would allocate a portion of them to the actual cost of manufacture of these briquets, would you?

A. Yes, that portion which would be, as far as could be estimated, actually incurred with respect to briquets its fair, scientific share.

Q. In the manufacture of the briquets, we know they have four people operating the machinery for

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the gathering of the sawdust, forming the sawdust into briquets, and moving them onto the railroad trains, and shipping them away. That is the only direct labor. And the only direct charge is a certain amount of power and fuel that is used in the manufacture of the [1121] briquets and a certain amount of material that is used to bind them. There is no difficulty in definitely and exactly, as you say, determining those direct costs?

A. Not much difficulty.

Q. Well, there isn't any difficulty if the books are kept properly?

A. Well, the difficulty is this: All the transactions in a plant must be documented before you can do any accounting with them, and if they don't document them, the withdrawal of materials from the inventories and stores so they can be charged to the manufacture of the briquets, then you have to find some basis of cost.

Q. But I am assuming a plant does that. It has a payroll on which the labor of these four men are kept and the definite amount of materials is kept down to the cent cost, and they also keep appropriate records and time sheets of those direct charges and the power that is needed.

A. Yes.

Q. There is no difficulty in determining the direct cost down to the penny that it costs the manufacturer to make those briquets? A. Yes.

Assuming that the price of those briquets decreased to a point where it does not equal his

(Testimony of George A. Maxwell.)

direct cost, and the manufacturer then discontinues making briquets and burns the sawdust; [1122] the overhead items you would allocate while these briquets were being made would go on, would they not?

A. Possibly but not entirely. The overhead with respect to that department would probably be reduced.

Q. Suppose the degree of reduction would be unascertainable and that any diminution of any overhead would be indeterminable, do you think you would still allocate that overhead to the actual cost of the manufacture of the sawdust?

A. Definitely, because the sale price has nothing to do with the cost of manufacture. The sale price might only be a fraction of the cost of manufacture of the briquets.

Q. Now, in determining whether he is going to make a profit on those briquets and his other overhead would go on whether he makes them or not, he is concerned with what it would cost him to make the briquets? A. Yes.

Q. And that determines the actual cost of the manufacture of briquets? A. Yes.

Q. Assuming that briquets sell for \$10 a ton and these direct charges, the actual cost involved in the manufacture of the briquets as distinguished from the overhead that would go on anyway, is \$5 a ton. He is making a profit of \$5 a ton he otherwise would not have if he shut down the briquet department, isn't that so? [1123]

(Testimony of George A. Maxwell.)

A. No, that is not so. The direct charge, labor and material, is not the cost of manufacture. Probably the overhead is more than those two put together. It often is.

Q. But the overhead is something I have told you in this situation would go on.

A. That doesn't make any difference.

Q. Well, in the case I mentioned to you, if the man decided he did not want to bother with these briquets and wanted to shut down that manufacture, he would be losing \$5 a ton for all the briquets he could have made, wouldn't he?

Mr. Rosenberg: Now, just a moment; I object to that——

The Court: Proceed. This is an expert witness on the stand.

A. (The Witness): It is quite possible if he discontinued making the briquets he eliminates a product, and he would eliminate the direct costs of that product, which would be material and labor, and perhaps eliminate, possibly, some of what is called overhead expenses or distributable expenses, and that is the reason they are called overhead, because they cannot be directly measured in respect to each product. However, it is conceivable that a plant might quite properly decide not to continue making briquets if the demand for production in other categories of its products was so great that it could not devote sufficient time to the briquets in the efficient management of the plant, and they decided [1124] not to bother with that particular product.

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But the same attitude is often taken with products not by-products, but which are primary products. And when products are eliminated from the process of manufacture—and I am thinking now as I answer your question of a textile plant that has seven or eight thousand different products, and frequently they find that their method and cost of manufacture for these products is such that they cease to be profitable and they are continually dropping numbers or classifications of products. If they drop them they eliminate the direct cost with respect to them, but it is not possible to ascertain the extent to which they reduce their overhead expense in consequence of that. They may not reduce their overhead expense in terms of dollar amount, but they may reduce their overhead expense in regard to cost per unit, if in dropping these products they increase others that are profitable to such an extent that maybe they can spread their expenses more thinly over the production.

Q. (Mr. Bennett): We have agreed, as I take it, from the previous answer, that it is possible to determine exactly the direct cost of manufacture.

A. Yes.

Q. And you agree with me, do you not, that these items——

A. Excuse me, I should add with reasonable limitation, because that cannot be done with mathematical accuracy. [1125]

Q. Why could not the situation of the sawmill, with the direct costs of the manufacture and the

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manufacture of these briquets be determined with mathematical accuracy?

A. For this reason, that one month the workers may be a little more efficient than they would be the next month, so that you might have the same direct wages, but they would produce more in one month than they would produce in the next month. That would give you a different per-unit-cost no matter what your common denominator might be, pounds, tons, or briquets, no matter what it might be. So the direct cost in the course of a year with twelve operating periods where you would have twelve different direct cost periods, each one of them mathematically accurate alone, but none of them accurate with respect to the whole matter. They may be selling a product in June which was manufactured in January. There is no rule——

Q. Let us get away from the matter of profit in selling things in June that may have been produced in January, but if during a year this little separation operation of molding this sawdust into these briquets is kept properly, wages of these men solely and exclusively engaged in this business, the exact amount of materials that have gone in there, and the power needed and the accurate record is kept of the total amount of briquets by tons produced during that period—you do arrive for the 12 months period at an accurate determination of the direct [1126] charges or direct cost of manufacturing, don't you?

A. Yes, over a period of a year.

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Q. Yes.

A. Within reasonable limits, still not mathematically accurate.

Q. So we don't talk too much, you agree it would be accurate for the year?

A. Reasonably accurate, yes.

Q. You so testified, as I understood your direct examination, that the reason you have to allocate these indirect things is that it is not possible to arrive at any mathematical or arithmetical degree of certainty, is that correct?

A. Not with respect to the amount of the expenses, but with respect to the amount of expenses allocable to each individual product.

Q. Yes, I understood that. We say we have an overhead of 50 indirect items of \$100,000. There is no question about the total?

A. That's right.

Q. But by the very nature of things it is impossible to figure arithmetically what portion of these 50 indirect items that comprise the \$100,000 should be directly allocated to the by-product, isn't that right?

A. That's right.

Q. Therefore, some estimate is made? [1127]

A. That's right.

Q. And in the nature of things that has to be an arbitrary estimate doesn't it?

A. I will avoid the word "arbitrary" because it should be scientific. It could be arbitrary and very erroneous.

Q. Yes, but any method of allocation, whether it is based on the relation of direct labor or rela-

(Testimony of George A. Maxwell.)

tion of values is in the final analysis an arbitrary allocation, isn't it?

A. I think the word "arbitrary" connotes something that may or may not be based on reason. That is why I would avoid that word.

Q. Supposing that the manufacturer just followed a system of allocating overhead on the basis of relative sale values.

A. Yes.

Q. That would in effect arbitrarily be assigning a certain amount?

A. That would be arbitrary, yes.

Q. And if he based it on some other system of direct labor cost, that, again, would be arbitrary, wouldn't it?

A. Yes, but not so arbitrary as on the basis of the sales value, because that would be erroneous.

Q. It would be a method that would not necessarily have an exact basis relation, is it?

A. That would also depend on the particular plant. You cannot use the same method of distribution on every plant. In one plant machinery may predominate, and in the other labor may predominate. [1128]

Q. In any event, the allocation of these charges, by the very nature of having to allocate them, produces the element of estimate or conjecture?

A. Yes.

Q. You can't do it with actual determination, can you?

A. You can't do it with actuarial mathematical accuracy

(Testimony of George A. Maxwell.)

The Court: We will take a recess.

(Recess.)

Q. (Mr. Bennett): I think, Mr. Maxwell, you referred to *The Cost Accountant's Handbook*, Ronald Press, as being the summation or the epitome of all the other discourse and writings on this subject of cost accounting.

A. It is a compendium of many authors' writings.

Q. That handbook devotes a whole chapter to cost accounting methods for by-products, doesn't it?

A. Yes, it does.

Q. And those methods are different, with the exception of one, from the methods prescribed or at least discussed for accounting for co-products or joint products? A. Yes.

Q. So this handbook itself does treat cost accounting for determining cost of by-products differently than is treated the determination of costs for co-products, isn't that a fact?

A. It makes a distinction, but I think if you will read it you will find it draws a very nebulous line between both, and also [1129] that it allocates the same cost accounting principles for both by-products and co-products.

Q. In co-products accounting it suggests that the co-products should bear the allocation of the overhead—in other words, the cost of the co-product is determined by its direct cost plus an allocated portion of the other costs? A. Yes.

Q. In other words, in the case of co-products,

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the cost is determined just as though there was one or two main products? A. Yes.

Q. In the case of by-products, the chapter suggests in the majority of instances actual determination of costs of the by-product are not made at all, but the proceeds from the by-product in various degrees are credited against the cost of manufacturing the main product?

A. No, I think you are in error there. The section—I think you will find it in Section 10—gives the various methods that the editor of the work has found in operation. He leaves the reader to probably make a selection of which method he may want to use with respect to a specific industry, but he also makes it clear that the best method is one which arrives at the realistic and factual cost of production of the by-product, which includes the direct charges plus its prorated share of the overhead.

Q. You refer now to the so-called seven methods. There are [1130] seven methods outlined in this chapter, and the seventh method is the one that provides for proration of joint costs, isn't that correct?

A. I can't recall whether that is the seventh method or whether there are eight, nine or ten. If I may look at the book——

Q. Yes, let me show it to you. I call your attention to page 502 of this book, "Cost Accountant's Handbook, Theodore Lange, Editor, Ronald Press," which is a part of the chapter "Joint and By-

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product Costs." And then we come to page 502, "Methods of Byproduct Accounting."

A. Yes.

Q. And the book states: "1. Methods of determining costs of byproducts.

"2. Methods of determining costs of joint products.

"3. Valuation of byproducts.

"4. Valuation of inventory of major products, byproducts and joint products——"

A. Yes.

Q. And then the book states, "There are several generally accepted methods of accounting for byproducts: 1. Net sales of byproducts treated as 'other income'—— A. Yes.

Q. ——"on profit and loss statement." No costs are assigned or attempted against byproducts?

A. That is right.

Q. "2. Total sales less total costs." That is another method, isn't it? A. That is right.

Q. A third method, "Total Cost less Revenue from sale of by-products." A. Yes.

Q. That is, again, no attempt is made to determine the cost of byproducts as you would a co-product, isn't that so?

A. Yes, because the cost of a by-product remains.

Q. "4. Total Cost less Value of Byproducts (including selling and administrative expense).

A. Yes.

Q. "5. Total Cost less Value of Byproducts (in-

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cluding subsequent costs and selling and administrative expense).

“6. Total Cost less Byproducts Valued at Standard cost.”

And then 7th and last. “Proration of Joint Costs.” A. Yes.

Q. Now, that is the method that you say you consider the best, the seventh?

A. Yes. Each one is better than the other. The most objectionable is the first one.

Q. Yes, and you consider the seventh as the best? A. Yes.

Q. Do you contend that this book states that that is the best [1132] method? A. Yes.

Q. Let us come to that. I refer you to page 522, where it speaks of proration of joint costs, and I quote, “Another method of byproduct accounting is to charge each product for costs subsequent to the splitoff point.” A. Yes.

Q. Even this suggests only charging these costs subsequent to the splitoff point? A. Yes.

Q. In co-products you do not start at the split-off point, do you?

A. Theoretically you do.

Q. But in actual practice you do not?

A. In actual practice you do.

Q. That is your theory?

A. Yes. The only thing is with respect to co-products, they do not really use the word “split-off,” because the co-products generally begin the process of manufacturing at, let us say, the receiv-

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ing department of the plant; but that is the split-off point with respect to even the primary product, because the raw material in the primary product is probably the finished material in another plant. So that even at the inception of manufacture of a primary product, that was really the splitoff point. And then when you come to a so-called byproduct, which [1133] does not arise until a number of processes have been gone through, that point is really the inception of the manufacture of that product, and for convenience it is referred to as the splitoff point because it takes its raw material at that point, its raw material being in consequence of what processing is taking place prior to that in the raw material included in the primary product.

Q. Let me give you this situation: Supposing a person has a mine where gypsum is mined, and in connection with that he has a plant where two products are produced, gypsum wallboard and gypsum plaster. A. Yes.

Q. Those are two co-products? In other words, the gypsum, as it comes from the quarry, is ground and dried and it is either taken to be made into wallboard or taken to be made into the plaster; you would consider those joint products, wouldn't you? A. Yes.

Q. And you would assess in that case, would you not, a cost beginning at the time that that rock is taken out of the mine, wouldn't you?

A. As a matter of fact, that is how it should be done, but that is not done very often, although au-

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thorities recommend that treatment. In other words, it is regarded as a conservative practice and regarded incidentally as the best practical practice, to begin assembling the costs on so-called by-products [1134] at the point of separation. However, that does not alter the fact that there are costs attaching to that by-product prior to that.

Q. I was talking about a co-product, then, Mr. Maxwell.

A. Well, there is no difference between a co-product and a by-product as to the accountant. They are one and the same thing. They are synonymous.

Q. And you contend that this book makes no distinction between co-products and by-products so far as cost accounting is concerned?

A. Well, it does.

Q. You do not agree with the book then?

Mr. Rosenberg: Just a moment. Let the witness finish his answer.

Mr. Bennett: I am sorry counsel. I was too fast. I did interrupt.

The Court: You must allow for the heat of the battle here.

Mr. Bennett: I am trying to move too fast.

The Witness: I would say even the book would be better if it made no distinction.

Q. And the fact that the book makes a distinction, you do not like the book?

A. No. I do like the book, but the book makes a distinction between by-product and the word co-product, which are so frequently used in conversa-

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tion and in discussing the products of a [1135] manufacturer, but they are nevertheless one and the same thing.

Q. None of these first six methods that they say are available for cost accounting of a by-product is employed at all in the chapter dealing with accounting for co-products, isn't that correct?

A. The authors say they find these methods in existence, very loose methods in existence. They have merely recited the methods they have encountered in their experience.

Q. There is another thing I wanted to cover here. I am going back to the book again, page 506. One of the methods suggested by this book is the total cost less value of by-products method; isn't that one?

A. That is one method, yes. Now he is referring there is the primary product.

Q. That is method No. 4, isn't it?

A. Yes.

Q. Now, he says there, "This method is an improvement over the prior methods by charging the by-product for selling and administrative expense and also for production costs subsequent to the splitoff point. In the manufacture of coke, for instance, the main product (coke) is charged for all costs up to the splitoff point, and subsequent costs are charged to each product as incurred."

A. Yes.

Q. "The net yield of the by-product (sales less cost) is then [1136] treated as a reduction in the

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cost of coke produced. Simple cost classifications make possible the determination and allocation of subsequent costs."

Then the next page and continuing, the book states, "In figure 3," which figure is below here as a detailed breakdown, "it is assumed that the joint cost—" "joint cost" is equivalent to what we are talking about as overhead, isn't it? A. Yes.

Q. "It is assumed that the joint cost is \$8,500, and the subsequent costs are \$500 for the main product and \$600 for the by-product. These figures make up the total production cost, which is therefore the same as in previous illustrations. Since the joint cost—(overhead)—"is charged entirely to the main product, the by-product inventory, when valued at cost, carries only subsequent costs. Thus the unit by-product inventory value is \$600 divided by 2500 units, or \$.24. This is the figure used in valuing the inventory of the by-products in the illustration."

The illustration shows down here that the joint costs or the overhead is all charged up to the main product.

A. Oh, no, it definitely does not show that because you did not read this right. This says, "Since the joint cost is charged entirely to the main product, the by-product inventory, when valued at cost, carries only subsequent costs."

Now, that does not mean only direct labor and material. [1137] In this particular instance, coke is the primary product. If gas was the primary prod-

(Testimony of George A. Maxwell.)

uct, then coke would be the by-product, and you merely reverse the situation.

Q. In this instance, you have agreed that overhead, as we have been talking about it, is the same as the author of this book speaks of joint costs?

A. Definitely not. I was in error on that. The joint costs here are the sum total of all costs incurred by the plant. That is precisely the meaning attached to that word here, and he is dividing them between both. In other words, he is taking all the costs, direct and indirect, and he is charging them to the main product here, which is coke, and then he relieves that cost of all subsequent costs attaching to coke, which he is treating as the by-product again, the inference being that all that remains is the cost of the coke, which is the primary product.

Q. But he says the joint cost or the overhead is charged entirely to the main product.

A. No, the joint cost there is the sum total of the costs of all products, which are all put into one pot, so to speak.

Q. Let us see by following the illustration if we do not actually get what he is talking about:

“Sales main product (1,000 units at \$10) \$10,000.

“Cost of sales:

“Joint cost (charged to main product) (1200 units), [1138] \$8,500.”

A. Yes, that is all expenditures.

Q. Yes. A. Not overhead.

Q. It is the joint cost, isn't it?

(Testimony of George A. Maxwell.)

A. Which is direct and indirect. The overhead is only part of that joint cost.

Q. Yes, but included in the joint cost is the overhead? A. Definitely, yes.

Q. And all the overhead is charged to the main product coke?

A. Yes, and then they take it out again and they credit for the by-product.

Q. Let us see if they take it out. I am not going to take time, Your Honor. Would Your Honor like to read this?

The Court: No. Counsel wants to see it.

Mr. Bennett: All right. I will have to go through it.

Q. "Joint cost (charged to main product) \$8,500.

"Subsequent costs main product \$500.

"Total charges to main product \$9,000.

"Less net yield from by-product:

"By-product sales, \$600.

"By-product inventories, \$360.

"Total by-product values, \$960.

"Less subsequent cost to produce, \$600."

And then they have deducted the selling and administrative [1139] expenses of \$80, showing "Total Costs and Expenses \$680," and the net yield of the by-product is \$280, isn't it? A. Yes.

Q. And the net production cost of the main product is \$8,720? A. That is right.

Q. Is that right? A. Yes.

Q. You agree that in that system employed in the coke situation——

(Testimony of George A. Maxwell.)

A. Yes, but you will find that book does not recommend that system. That is the system they find in operation. There he has deducted the sales value of the by-product from the total joint sales. No accountant recommends that who understands his business.

Q. Let me see what they say about this particular method we are talking about. They say it is an improvement over the first three methods.

A. Yes, the first method is the worst and has no basis in reason whatsoever.

Q. And they commend it for this reason, that simple cost classifications make possible the determination and allocation of subsequent costs. In other words, the book commends that method at least, doesn't it?

A. No. I think if you will look at those figures you will see that the subsequent costs attaching to the product were not [1140] deducted from the joint costs, but rather the sales value. I think, if I remember the figures you read, the cost of the by-product was supposed to be \$600 there, whereas they deducted \$280, which was the sales value of the by-product, from the total costs, isn't that correct?

Q. That is right.

A. That has no basis in reason whatever.

Q. This indicates that they determine the actual costs necessary to produce the by-product at \$600. They deducted, or rather, they added the administrative and selling costs of the by-product and the

(Testimony of George A. Maxwell.)

total cost was \$680, or a net yield figured for the by-product of \$280. A. Yes.

Q. But the point I wanted to make in that method, the allocation of plant overhead was allocated to the main product and not to the by-product?

A. No, it was included in the subsequent costs. If it is not, then those are not subsequent costs because the overhead is a part of the costs.

Q. You just assume that. There is nothing in this method that suggested that, is there?

A. No, I think that is axiomatic.

Q. Now we come down to the final method, the last one that is mentioned here, and all that is said about that is as follows on page 522: [1141]

“Another method of byproduct accounting is to charge each product for costs subsequent to the splitoff point, and to apportion the joint costs between the major and byproduct on some acceptable basis. Some authorities consider this method superior to the others, but there is no logical basis for this view, except the fact that a cost is attached to each product.”

A. Yes, the Treasury Department also recognizes that method where a better one is not available.

Q. You dispute, then, what the author says about it, what the book says?

A. No, but I would like to have the opportunity to read something from that chapter myself.

Mr. Bennett: The witness volunteered what the

(Testimony of George A. Maxwell.)

Treasury Department recognizes and I was talking about this book. I move to strike the reference to the Treasury Department.

The Court: The question and answer may stand. The objection is overruled.

Redirect Examination

By Mr. Rosenberg:

Q. You said there was something you would like to refer to, Mr. Maxwell?

A. I have difficulty finding what I am looking for.

Q. (By the Court): What page are you on?

A. Page 524. [1142]

A. Perhaps I should read this section, here. That is headed, "Summary of Methods of By-Products Accounting," if I may.

Mr. Bennett: Where are you reading?

A. Page 523.

Q. (By Mr. Rosenberg): Go ahead and read what you want to read, Mr. Maxwell.

A. Well, it says,—

"The first two methods of by-product accounting discussed above, 'Other income,' and 'Total sales less total costs,' cannot be seriously considered as representing a solution of the problem of jointly incurred costs of production, especially since the by-product entries are made only at the time of sale rather than at the time of production. The next three methods, consisting of adjustments to the joints costs in various forms, are sometimes referred to as market value methods.

(Testimony of George A. Maxwell.)

“The next cost of the major product is determined by deducting from total costs the recoverable values of the by-products. These values are determined in one of the three following ways”——

Q. (By Mr. Rosenberg): Stop right there: Under those methods do you determine cost of production for the by-product or are those methods where a formula is suggested for crediting against the cost of the main product the cost of the by-product?

A. It winds up, as a matter of fact, by pointing out that the [1143] cost of the by-product should be ascertained and credited against the cost of the primary product, or, rather, it describes that as a method.

Mr. Bennett: The witness is not reading. He is merely giving his own impressions.

The Court: He is an expert witness.

Mr. Bennett: All right.

Mr. Rosenberg: I see the grand jury is here. I will not ask any further questions.

(Recess.)

The Court: Since we have been reckless with our time up to this point, the Clerk informs me the matter can go over until Friday.

Mr. Bennett: I will stipulate that this next witness Mr. Rosenberg intends to call will give the same testimony as the two preceding experts that have testified.

Mr. Rosenberg: That is a Greek gift, your Honor. I don't choose to accept that.

Mr. Bennett: I had that in mind.

The Court: I am going to adjourn today until Friday morning at ten o'clock.

Mr. Bennett: There are one or two matters that are undetermined, of which I spoke to your Honor before; for instance, in this matter of the issue of some \$1500 as to deductions around their chemists, and their contentions are that we owe them [1144] that, and we contend otherwise. I don't feel that this court, in view of the busy calendar it has, should be taken up in trying that issue. I have not yet arrived at any understanding with counsel, but I have a feeling that we can and should in some way dispose of that. I think we can do that.

Mr. Rosenberg: I think we can.

Mr. Bennett: That will leave only the main issue for the court, the interpretation of the contract. There are only two or three paragraphs that have to be construed——

The Court: Nos. 3, 5, and 6.

Mr. Bennett: Yes, No. 3, 5, and 6. The testimony I have will be very brief, and I think it is possible we might finish by Friday noon.

The Court: Then, what is your thought?

Mr. Rosenberg: I will be willing to argue it orally, or to brief it, whichever method the court thinks would best suit the court.

The Court: I might add that unless I change my mind I would be able to dispose of it right now.

Mr. Bennett: I hope your Honor does not mean that adversely to us.

The Court: I say that kindly.

I would like to focus my mind on this problem, that I thought if both sides could simultaneously submit a brief in ten days it would be helpful to me in disposing of this case. [1145]

Mr. Bennett: With the right of reply?

The Court: No reply.

Mr. Bennett: I know your Honor is anxious to dispose of this case. I feel it is a highly commendable attitude, but I think, after all, nothing is settled unless it is settled well, and I want to furnish your Honor as meticulously as I can with material——

The Court: I will not foreclose you from presenting any material you wish.

Mr. Bennett: I will do what your Honor wishes on that, but it does seem to me that we might get things in better shape for a decision by following the usual practice of opening, replying and closing. However, if your Honor has different desires, we will meet those, whatever they may be.

The Court: I never make any pretense of telling counsel who have devoted their time and energies on both sides of any case, what to do. But I had that thought in mind, and I expressed it for what it may be worth.

Mr. Rosenberg: I will be in accord with the suggestion for simultaneous briefs, but frankly I would like a little longer time. This has been a rather arduous trial, and it has involved a lot of work at night in addition to the time in court, and, frankly, I am a little weary, and would like

a few days' respite before jumping into the thing again. [1146]

The Court: Very well. Then you may have 10, 10 and 5.

Mr. Bennett: That would be after this case is completed?

The Court: We are going to complete it Friday morning.

Mr. Bennett: Yes, I think so, Your Honor. I have a couple of short witnesses.

Mr. Rosenberg: Before we adjourn, and before I forget it, I would like to get into the record this matter. Mr. Bennett asked me to provide him with the figures on the production of ethyl-dibromide at this plant during the periods in question. I have that information and I have given it to Mr. Bennett. He also asked for the laboratory report that was made on this test where they processed gypsum in the plant, that is, tested for the purpose of determining whether they could produce gypsum without the use of sulphuric acid. I have brought in that report for Mr. Bennett. If he wants that to go into the record I am perfectly willing that it should go in. But I want the record to show I made that offer.

Mr. Bennett: I don't consider that report of the laboratory any report at all.

The Court: At any event, let it be marked for identification.

Mr. Bennett: Are you willing to offer these in evidence?

Mr. Rosenberg: You asked for them.

Mr. Bennett: I wanted the laboratory report in connection with the corss-examination of your chemist, but that now seems [1147] impossible. If you want to offer that in evidence, I will not object, but I do not want to be bound by that.

Mr. Rosenberg: Then I don't see any purpose in putting these in.

The Court: Well, it was asked for.

Mr. Rosenberg: I will put them in then. The laboratory report will be offered as our next exhibit in order.

The Court: Let it be marked for the purpose of identification.

(Laboratory report in question was marked Defendant's Exhibit L for identification.)

Mr. Rosenberg: This next one should go in evidence. That is something Mr. Bennett asked for. In this next document are figures on the production of ethylene-dibromide.

Mr. Bennett: Now, nothing is shown as to value. I understand this is worth something like \$2,000.

Mr. Rosenberg: I don't like to be unkind, Mr. Bennett, but if your information is so completely erroneous——

The Court: Out of line——

Mr. Bennett: Out of line, yes. It may be, I don't know. Can you supply me at this time with market values of these ethylene-dibromide figures which are listed on this yellow sheet that you are now offering in evidence during those periods of time?

Mr. Rosenberg: I will get that for you. [1148]

The Court: Very well. Let that document be marked in evidence.

(Yellow sheet containing figures on ethylene-dibromide was thereupon marked Defendant's Exhibit M in evidence.)

DEFENDANT'S EXHIBIT M

ETHYLENE DIBROMIDE PRODUCTION

July 1, 1945	July 1, 1944		
June 30, 1946	June 30, 1945	Year 1943	Year 1942
271T	719T	485T	507T
July 1, 1940	July 1, 1939		
June 30, 1941	June 30, 1940	Year 1938	Year 1937
592T	550T	445T	341T

The Court: We will stand adjourned until Friday morning at 10:00 o'clock.

(Thereupon an adjournment was taken in this matter until Friday, January 2, 1948, at 10:00 o'clock a.m.)

CERTIFICATE OF REPORTER

We, Official Reporters and Official Reporters pro tem Certify that the foregoing Transcript of Record pages is a true and correct transcript of the matter therein contained as reported by us and thereafter reduced to typewriting, to the best of our ability.

/s/ J. J. SWEENEY,

/s/ F. J. SHERRY,

/s/ KENNETH G. GAGAN. [1149]

Friday, January 2, 1948, 10:00 o'Clock A.M.

DeWITT ALEXANDER

called as a witness on behalf of defendant; sworn.

The Clerk: Give your name.

A. DeWitt Alexander, also known as A. DeWitt Alexander.

Direct Examination

By Mr. Rosenberg:

Q. Where do you live, Mr. Alexander?

A. My residence is Berkeley, California.

Q. What is your profession?

A. Certified public accountant.

Q. Since when have you been a certified public accountant?

A. September, 1921, in the State of California.

Q. Will you give us a brief outline of your experience since the time you were certified as a public accountant?

A. I have been in public practice in public accounting since 1919—well, since I received my certificate, as you say. I was a partner of the firm of Robinson Nowell & Company, in San Francisco, from 1925 until 1943. Since 1943 I have been with Peat, Marwick, Mitchell & Company, public accountants and auditors. And for the last year and a half I have been resident partner of Peat, Marwick, Mitchell & Company in San Francisco.

Q. That is a national firm of certified public accountants, is it?

A. It is a national firm and international firm, the American [1150] firm having 40 offices in North America.

(Testimony of DeWitt Alexander.)

Q. You are a partner of that firm and the resident partner in charge in San Francisco, is that so? A. Yes.

Q. What are your functions as resident partner of that firm?

A. I am responsible for the activities of the office, for keeping up our professional standards, keeping informed, myself, of up-to-date professional knowledge and carrying out that responsibility.

Q. What societies do you belong to or have you been a member of?

A. I have been a member since about 1923 of the American Institute of Accountants and the California Society of Certified Public Accountants.

Q. Have you had any experience in cost accounting, Mr. Alexander?

A. I have had a very varied practice, if I may say so, and it has included cost accounting.

Q. That has been over the years, has it?

A. Oh, yes.

Q. I am going to ask you to assume the existence of a chemical plant which is recovering from a common raw material three different products, which I will designate as products A, B, and C, and ask you to assume that product B is technically a by-product in the sense that it consists in part of a chemical element which must be extracted from the raw material in order [1151] to produce product C in the pure and salable form, and to

(Testimony of DeWitt Alexander.)

assume that in order to convert product B into a salable commercial product after it is separated from the raw material it is necessary to process it, and for the purpose of such processing a physical plant is required which is devoted exclusively to this processing, and labor is employed which is devoted also exclusively to the processing of the product, and I will ask you to assume further that by reason of a contract it is necessary that the manufacturer determine the cost of the production of product B, and under those circumstances will you state whether or not, in your opinion, it is proper and good accounting practice to include in the cost of production of product B a portion of the plant overhead? A. Yes.

Q. And under the same assumed circumstances would it be proper and good accounting practice to include in the cost of production of product B a portion of the indirect charges of the plant, such as general superintendence and other charges for labor which are devoted to the production of the several products, including product B, but as to which it is impossible or impracticable to keep records of the actual time devoted directly and exclusively to each of the particular products?

A. Yes.

Q. Having in mind the same assumed circumstances, would you [1152] say that it would be improper to include in the cost of production of product B any charges which would continue, notwithstanding that the production of product B were

(Testimony of DeWitt Alexander.)

discontinued, although in some lesser or unascertainable amount? A. Improper? No.

Q. Under the same hypothesis, Mr. Alexander, I will ask you to assume that a shipping department is maintained in this plant from which products A, B and C are shipped, and that the direct labor that is employed in the handling and shipping of each of the three products is accurately recorded by time card and is charged directly to the respective products on which the labor is performed, but that the expenses of foreman, assistant foreman, shipping clerk, demurrage, and tractor expense in connection with the handling of the products is allocated between the three products in the proportions that the tonnages of the three respective products bear to the total tonnage shipped. In your opinion would that be good and proper accounting practice?

A. You stipulate there that the tonnage is fairly representative of the allocation? Yes.

Q. It is allocated on the basis of the tonnage handled of the three respective products.

A. Yes, normally so. There might be exceptions as to the method of allocation.

Q. Would there be any question in your mind that these expenses [1153] that I have mentioned of the foreman and the assistant foreman, and so forth should be allocated to the three products handled on some proper basis? Is there any question about that? A. No question, whatever.

(Testimony of DeWitt Alexander.)

Q. Will you state this, Mr. Alexander, as a general proposition: In the case of the production of a by-product which requires some physical plant and some direct labor in order to make it a commercial product and salable as such, as a general product, is there any reason in your opinion for employing any different methods or principle in determining the cost of production of that product than you would employ in the case of what are commonly designated as co-products or joint products?

A. No, I accept as a principle that all the proper and accepted methods of accounting are equally applicable in the case of a joint product or a by-product, the only difference being due to necessities and expediencies.

May I say this: I could be challenged on that statement, but not if I say for the purpose of by-product accounting all the good and proper methods are sound until expediencies and necessities become the proper and sound thing to do in lieu of actual cost determination.

Q. You mean by that it is not uncommon for other accounting methods to be employed in the case of by-products?

A. You say it is not uncommon? It is very common to use expediencies. [1154]

Q. What expediencies, for instance?

A. Oh, crediting the sales to the cost of the main product, crediting sales to miscellaneous income—pure expediencies.

(Testimony of DeWitt Alexander.)

Q. But do those expediencies result in determining the cost of production of a by-product?

A. Oh, they are not a determination of the cost of a by-product at all in any sense.

Q. Why are those methods employed in some instances?

A. Well, I frequently put it this way: The very cost of pushing the pencil to determine the cost is not worth the trouble.

Q. In the case which I have assumed, where by contract it is incumbent upon the manufacturer to determine cost of production, is there any question in your mind and in light of your experience as to what is the proper accounting method to be employed in determining cost of production?

A. No, provided, of course, that the by-product is not so minor that your costing becomes a little dubious as to its accuracy. That would be the case in the case of a by-product whose value was .1 of 1 per cent of the main product, or something of that sort. You would be getting into extremes.

Q. Are you familiar with the manufacturing processes of the Westvaco Chlorine Products Company at its Newark plant? A. Yes.

Q. Have you had occasion to visit that plant and to acquire some familiarity with those processes? [1155]

A. Yes, I visited the plant and I have been through it, I would say, if I may be permitted to do so, fairly thoroughly twice.

(Testimony of DeWitt Alexander.)

Q. Have you familiarized yourself generally with the production of gypsum in that plant?

A. Yes.

Q. Will you state whether or not in your opinion, and assuming that it is necessary for Westvaco Chlorine Products Company to determine the cost of production or cost of manufacture of gypsum, would you state whether or not the accounting methods to be employed would or would not be those that you have stated in these hypothetical questions to be properly applicable to product B?

Mr. Bennett: Just a moment. Your Honor, I do not want to delay this any more by objection, but it seems to me that that is a situation of injecting elements that have really not been before the court. The witness, an expert witness, is asked, "Did you go down and examine the plant? Do you think this method is proper?" That has two vices, as I see it: One that enables him to base an opinion on facts upon which neither counsel nor the court knows of their knowledge, because of not having had the opportunity of determining precisely on what elements he bases such an opinion, and that is why in the case of experts the proper and customary practice is to state a hypothetical situation, stating certain [1156] elements upon which such expert testimony is given. I object to this question on the ground it is incompetent, irrelevant and immaterial.

Mr. Rosenberg: I think the witness has stated that he is familiar with the processes there. He is

(Testimony of DeWitt Alexander.)

subject to cross-examination, if the Court please. If he does not have the proper background I am sure Mr. Bennett is competent to bring that out. I am perfectly willing to ask him to describe the processes there upon which he based the opinion that I have asked him for, if the Court would prefer. I will withdraw that question.

Q. Mr. Alexander, will you just describe in a general way the processes at the Newark plant, the manufacturing processes there, that is, the physical things that you have observed there and the things that you know about the manufacturing processes at the plant?

A. You say in a general way?

Q. Yes, just in a general way.

A. Well, I have observed the settling tanks where the magnesium sulphate is brought in and the calcium chloride added, and I have observed the process by which after the calcium sulphate, the gypsum, which as I understood it is hydrous calcium sulphate, has been withdrawn out of the settling tanks and put through the drying and grinding or partially grinding and other processes in the gypsum plant down to the shipping and packing. [1157] And I have observed the magnesium side of the plant and have had the processes described to me. I have observed from an exterior angle the rotary kilns, the kilns in which magnesium oxide is prepared from the magnesium chloride and the packaging and processing of them.

(Testimony of DeWitt Alexander.)

I have said something packaging of gypsum. It is not packaged. But I have seen the packaging of the magnesium. And I observed in a general way, not as a plant superintendent, but as an accountant will, to gain an idea of the extent of the operations, the gypsum plant, and I find it is essentially what I would call a factory stuck in the middle of the magnesium plant. I can't say whether in physical magnitude it is one-quarter, one-half or one-eighth, as an engineer might measure it, of the magnesium plant. But I did observe from an accountant's point of view, with special reference to the operations in the gypsum plant, it is a material manufacturing plant in the same location.

Q. Upon that background——

Mr. Bennett: Just a moment. I think I should move to strike the witness' conclusion or his statement that it was a factory within a factory, that it was a material factory, and of substantial extent, and so forth, as a conclusion and opinion of the witness that the witness or anyone else visiting the plant would not be permitted to draw upon.

Q. (By the Court): You observed this while you were down there? [1158]

A. Yes, and I have already said I am not a plant operator.

The Court: It goes to the weight of the testimony. I will allow it. Proceed.

Q. (By Mr. Rosenberg): Upon that basis, Mr. Alexander, will you state whether or not, in your expert opinion, in determining the cost of the pro-

(Testimony of DeWitt Alexander.)

duction of gypsum, and it being obligatory upon Westvaco to do so, whether or not the accounting methods that you have testified as being proper to apply in the case of the hypothetical product of B would be applicable in the case of the gypsum?

A. Yes, and may I be permitted to say that this observation of the extent of the processes is one factor. The economic value of the total output of gypsum compared with the magnesium, the extent of processing, the number of employees, the cost of those employees, such other facts as the availability of bookkeeping staff to carry out the proposition—all those factors, and I could name their importance in order, including observations of the physical processes—based upon all that I would unquestionably say that they could and should keep complete cost accounting of the so-called by-product gypsum.

Q. And would that include overhead and indirect charges of the nature that we have been discussing?

A. Yes, definitely. I do not see the warrant for the expediency of omitting those. [1159]

Q. Directing your attention to Plaintiff's Exhibit 18, Mr. Alexander, and particularly the third page entitled "Overhead and General Plant Expense," you have had an opportunity to inspect that prior to the time of taking the witness stand, have you?

(Testimony of DeWitt Alexander.)

A. This appears familiar; yes, in a general way.

Q. Will you state whether or not you consider the items that are included on that sheet in making up the aggregate overhead expense, proper items of overhead expense to include in the cost of production of gypsum? I am not speaking of amounts now. I am merely speaking of items as items of overhead expense.

A. Yes. I think I should add that my answer is affected a little bit by further inquiries beyond what I have seen here. Yes.

Q. Just one further question. Will you state whether or not, in your opinion, you consider it proper to use the straight line method of depreciation of equipment, such as the equipment in the so-called gypsum plant, by which I refer to the equipment that is used exclusively in the processing of the gypsum? A. Yes.

Q. Would you consider it proper to depreciate that on a straight line basis? A. Yes.

Q. Will you state on what you base your opinions that you have [1160] expressed, Mr. Alexander?

A. In the first place, depreciation is one of the most difficult things in all accounting to determine, and while I would hesitate to say whether straight line depreciation is used in 90, 95 or 99 per cent of all accounts that we examine, nevertheless it appears to be the best way of determining depreciation that we have before us in most cases.

(Testimony of DeWitt Alexander.)

In this particular plant—and I have had a little prior familiarity with plants in that same locality dealing with salt—and based on information that I have obtained there, it is quite obvious that the apparatus and other equipment at this plant primarily has a useful life based upon the time element. It is subject to very heavy corrosion. It is not to be compared with a machine tool, where a good industrial engineer would perhaps estimate it would produce so many items. Not this equipment. From all the information I could gather it wears out on a time basis, which calls for what has been spoken of—it has been used in this courtroom—straight line depreciation.

Q. The opinions generally that you have expressed from the witness stand this morning, on what do you base those opinions?

A. You are speaking of the theoretical question of accounting?

Q. The hypothetical questions, yes.

A. Based upon my experience, on previous thinking and analysis of the costing of so-called by-products, supported by research [1161] which I have had made under my direction at this time to see whether the authorities would agree or not with my pre-existing ideas of so-called by-product accounting.

Mr. Rosenberg: No further questions.

The Court: We will take a recess.

(Recess.) [1161-a]

(Testimony of DeWitt Alexander.)

Cross-Examination

By Mr. Bennett:

Q. You have been in the courtroom most of the time since this case has been on trial, haven't you?

A. Not most of the time, but I suppose most of the time when the accounting testimony has been carried on.

Q. You have been the auditor in the employ of the defendant covering a period of years, for the last several years in connection with this controversy that has existed between the defendant Westvaco on the one hand, and Pacific Portland on the other.

A. My firm has been employed by the company in its New York office and with the assistance of our office (and other offices, I presume), has been the auditor of Westvaco.

Q. You personally have had some knowledge of this controversy that has existed between the plaintiff and the defendant involved in this case some time previous to the actual trial of this case?

A. My first knowledge of this case was when I returned from the East, November 16, 1947.

Q. And from that time you collaborated with the defendant's counsel in preparing this case for trial?

A. Yes.

Q. As I understand, you would treat the matter of gypsum here just as you would a primary or co-product production?

A. Yes, unqualifiedly. [1162]

(Testimony of DeWitt Alexander.)

Q. And not treat it in any respect as a by-product?

A. There has been so much said about by-product here that I would like to have a definition of it before I answer that question.

Q. Without going into detail, as I understand it, you would treat, so far as the determination of costs, gypsum just as you would a primary or a co-product manufacture, wouldn't you?

A. Yes.

Q. And that has been the basis and the advice you have given the defendant and the testimony that you have given on the witness stand?

A. Yes.

Q. I suppose that you would also agree with the testimony of the witnesses Farquhar and Maxwell?

A. Yes.

Q. In other words, on this item of depreciation you would approve the so-called straight line method of depreciation because of the corrosion factor, is that correct?

A. I would approve of it because it appears to be the best available method in this case, and that is greatly strengthened by the factor of heavy corrosion.

Q. Suppose you rule out completely the corrosion factor and take into consideration the particular facts of this case where a comparison of costs of production in the manufacture of gypsum in two related twelve months periods would effect a price [1163] increase per ton from the manufac-

(Testimony of DeWitt Alexander.)

turer, Westvaco, to the purchaser, Pacific Portland Cement Company, if and when there was an actual advance in the cost of manufacture in those comparative periods: assuming under those circumstances there was no question of corrosion; would you still say the straight line method would be the proper one to employ?

A. I assume so, if estimating the useful lives of the two different periods had been fairly determined. May I add to that, I don't know the exact reason for the alleged increase in depreciation here, but if for outside reasons less is produced in the same plant as had been in the earlier years and other conditions were the same, it is obvious the cost of use of that plant—if I may use that term, although it is not an accounting way to express it—that cost will have increased per unit.

Q. If, in other words, a manufacturer for some reason of his own or by reason of some change of circumstance of the use of products that would facilitate or further the production of magnesium to the extent of the plant capacity, but at the same time the production of the gypsum which is taken out of the raw materials and goes on to produce magnesium oxide would be reduced to half; that would arbitrarily, would it not, increase the depreciation charge per ton of gypsum 100 per cent?

A. That would increase it 100 per cent. Let us understand each other, though, as to what we mean by "arbitrarily."

(Testimony of DeWitt Alexander.)

Q. If the tonnage went back up to its previous production, the [1164] depreciation charge would pay for all the machinery, wouldn't it?

A. Would you please say that again?

Mr. Bennett: Will you read the question?

(Question read.)

Mr. Rosenberg: Over what period of time? That is the purpose of depreciation, to depreciate a piece of property over its life.

Mr. Bennett: I think that is perhaps a matter of argument.

Q. But, in any event, and in the next year the production was brought back to its normal, say, of 20,000 tons where it had been dropped the preceding period to 10,000 tons, by this application of increased price it would greatly add to the depreciation charge for that particular year, wouldn't it?

A. You are speaking of the results?

Q. Yes. A. Yes.

Q. The thing we are endeavoring to determine is the unit cost per ton under the situation I have given you and I am trying to speak now not for a situation where only the manufacturer is concerned, but the situation I gave you where a purchaser's price was to be effective per ton above a stipulated contract price, and if there is by reason of the decrease in production a corollary increase of 100 per cent in depreciation rate for that year, and that is carried on into the next year as an added cost of production because of that application of straight line [1165] method of deprecia-

(Testimony of DeWitt Alexander.)

tion—that is correct, isn't it?

A. I don't quite understand that; but in that subsequent year wouldn't the cost per unit go down?

Q. Well, the price does not go down in the situation I am giving you, Mr. Alexander——

A. That is because of the terms of this contract, isn't that right?

Q. Yes.

A. Am I permitted to say that the interpretation of the contract in those respects is not my concern?

Q. No, you are dealing with the situation that affects the manufacturing itself, is that right?

A. I was trying to give, and I hope I gave it correctly, a picture of the accountant's best procedure in respect to depreciation charge determinations.

Q. And not in relation to any special situation posed by a contract that might be involved.

A. No, a contract might say specifically that depreciation was not a part of the cost.

Q. And it might contain other situations or conditions that would change or influence your opinion in that respect.

A. Pardon me?

Mr. Bennett: Will you read the question?

(Question read.)

The Witness: Yes. [1166]

Q. (By Mr. Bennett): As provided by contract.

A. Oh, yes, we could have innumerable clauses in the contract.

(Testimony of DeWitt Alexander.)

Q. You stated, as I understood it, that you would include a proration or allocation of all of these items of "overhead and general plant expense" that appears on a page entitled "Overhead and General Plant Expense" in Plaintiff's Exhibit 18. You would do that irrespective of the fact that no attempt had been made to allocate individually the items even in the case where the items were grouped together and you would take the total.

Mr. Rosenberg: That is assuming a fact not in evidence.

Mr. Bennett: In connection with counsel's objection, Your Honor, I will read thereon a note appended to this page:

"Only a few of these component items are individually allocated on the books. In the actual accounting most of the overhead items are grouped and the aggregate is allocated to the various products produced. Therefore, any attempt to allocate each individual item is somewhat hypothetical. However, the totals accurately reflect the aggregate overhead actually charged to gypsum during the years in question. The comparison has been made on this basis at the request and for the information of Pacific Portland Cement Company."

Mr. Rosenberg: But that shows they were allocated in that way from individual records. They were not set down like one piece of carbon paper or one ream of writing paper, but they [1167] are actual records and the amounts are set forth by the books itemizing each individual item. If you

(Testimony of DeWitt Alexander.)

want to go back and go to the trouble and labor and expense of going from the books to the original records, the original records would support the books.

Mr. Bennett: Well, the point is that this language speaks for itself, and as I read it, with the exception of a few, all of these items are grouped as the statement that you prepared states and the aggregate of that group is allocated to the various products produced, including gypsum.

Q. You would still, nevertheless, allocate an aggregate of all of these items, would you, Mr. Alexander, without any reason as to how or in what way the particular items specifically had to do with the production of gypsum?

A. Yes, but may I add that the accountant's aim within the realms of practicability is to subdivide his groupings. It is all a question of allocability and it is very common and it is very sound to take the whole aggregate and allocate it on some rational formula.

Q. That involves in a sense an arbitrary allocation?

A. In a sense, an arbitrary allocation, yes.

Q. And it may include, say, 5 or 10 or 20 per cent of an allocation of an item that may in actual fact have little or no relation to the actual production of a particular product at the plant? [1168]

A. Yes, if I may be permitted by His Honor to digress for a moment, I have heard something in this courtroom where I found a little misunder-

(Testimony of DeWitt Alexander.)

standing not only in the courtroom but outside. If I may use a homely illustration, if you take 10,000 bushels of wheat from Farm A and take 10,000 bushels of wheat from Farm B and put them into a grain elevator, you have then what you attorneys know as fungible goods; and let us say half of that wheat goes to Chicago and half of that wheat goes to Kansas City. It is not fair, or it is not proper after that to say that half the wheat from Farm A went to Chicago and half to Kansas City. Have I made it clear?

Q. You have made it clear, so far as that example is concerned, but I don't understand that that is involved at all in this case.

A. I don't mean to digress, but if you take an aggregate and allocate it, it is not proper to take one item of the total and say a part of that has been allocated to one item or another.

Q. But that is when you are dealing with practicability and convenience and determining for the purpose of the manufacturer his cost. Is that what you mean?

A. No, that procedure of going as far as practicable will allow the making of a rational allocation of all your overhead and has been found acceptable in accountancy experience and has been used consistently in accounting under cost plus contracts and without any question, I think I may say. [1169]

Q. That is according to your view of it. Let me ask you one or two more questions.

(Testimony of DeWitt Alexander.)

A. You say, "according to my view"—I had in mind the manual of the War Department and the Navy Department on the subject.

Q. That is merely where the price to the government is based on cost plus a certain increment of profit, isn't that so?

A. Usually, yes, but the pamphlet does not specify that type.

Q. And in cases where the elements of cost are usually divided and specified in the contract, too?

A. No, they are not usually divided.

Q. Take the case of research for new products and assuming that this research is directed to finding a new product to be made out of this calcium sulphate, which with two molecules of water and after drying and grinding forms gypsum, which is sold to the Pacific Portland Cement Company where the research, as I say, is devoted to finding some other product to manufacture out of this calcium sulphate which is drawn from the main product in order to manufacture the oxide. Will you consider that that research cost or a portion of it should be allocated in the situation that I gave you to gypsum where such allocation would, if it increased in any comparative twelve-month period, would increase the cost of production or manufacture of gypsum?

Mr. Rosenberg: To which I object on the ground the evidence is uncontradicted, if Your Honor please, that so far as [1170] new product research is concerned, is confined and devoted to research

(Testimony of DeWitt Alexander.)

for new products from bittern, not from magnesium sulphate.

Mr. Bennett: One of your witnesses, Mr. Wallace, I believe, stated that part of this research had to do with finding some new methods or use of this so-called waste material, the sulphate that is taken out of the magnesium to produce a product other than gypsum which obviously could in no way benefit the plaintiff in this case.

Q. Would you consider it proper in the situation I have given you, to allocate a portion of that research to the actual cost of manufacture of gypsum?

A. You are speaking of research and you don't mind if I repeat this, you are speaking of research under which the hydrous calcium sulphate, the gypsum, will be used for a different purpose than gypsum?

Q. Yes.

A. Oh, no, that is not a proper charge. That is a new and major development of the company.

Q. Even though one of those items is allocated by aggregate——

A. For a specific new development like that, I would say no; but please understand, it is that specific thing that I would not allocate.

Q. Let us take the item listed here under "West Coast Subscriptions and Donations." Where there is a new and major development of the company. be affected by any of the cost of manufacture of gypsum, would you allocate a portion of the dona-

(Testimony of DeWitt Alexander.)

tions and subscriptions to West Coast that the defendant sees fit to donate or give?

A. Yes. While it is quite possible they might go to excess, I would say the accountants today generally recognize a certain amount of donations and even more so, subscriptions are necessary and normal for the conduct of a business enterprise.

Q. That is so far as the working out of some system of allocating costs for the sole purpose of the manufacturer himself?

A. No, we included it in our cost for all purposes.

Mr. Bennett: That's all.

Redirect Examination

By Mr. Rosenberg:

Q. Just on that last subject, Mr. Alexander, would you say that donations and subscriptions in an annual amount of \$51.55 charged to gypsum which is too small to even affect the unit cost of gypsum would be an excessive amount to include in general overhead?

Mr. Bennett: That is not proper. Well, I will waive the objection.

A. No, and I don't think you would have to be an accountant to answer no to that question.

Mr. Rosenberg: Defendant rests.

(Defendant rests.) [1172]

Mr. Bennett: I feel, Your Honor, if I can rush through we will probably be able to finish after this witness and another.

The Court: Very well.

J. HUGH JACKSON

called as a witness on behalf of plaintiff in rebuttal, sworn.

The Clerk: Will you state your name to the Court?

A. J. Hugh Jackson.

Direct Examination

By Mr. Bennett:

Q. What is your present occupation, Mr. Jackson?

A. I am professor of accounting and dean of the graduate school of Business at Stanford University.

Q. How long have you been professor in accounting at Stanford University?

A. I have been there for 21 years.

Q. How long have you been dean of the graduate School of Business Administration?

A. This is my 17th year.

Mr. Rosenberg: Now, just a minute. Do I understand you are going to put on some more expert testimony?

Mr. Bennett: I think that would be the nature of this evidence.

Mr. Rosenberg: I think that is not proper rebuttal. That [1173] is part of the plaintiff's case in chief and I don't presume that we are going to start now alternating putting on expert witnesses. That was part of their case in chief to put on ex-

(Testimony of J. Hugh Jackson.)

pert testimony. They did that and I put my experts on. I would object very strenuously now to any additional expert testimony which is part of their case in chief and not proper rebuttal. Counsel put his expert testimony on and then I put mine on. If the purpose is to fortify or rehabilitate their experts by further testimony, that is not proper rebuttal.

Mr. Bennett: I think it is, Your Honor.

The Court: I may assist you. I think his position is well taken. Now, so that I am not mistaken about it, indicate for the purposes of the record what this witness is to testify to by your calling him.

Mr. Bennett: Your Honor, this witness is going to be asked the precise question that the defendants put to their experts. He, in his case, has brought certain experts to give testimony on a basis, I think, different in degree than that which we would offer, at least, as to the scope they intend to cover. I only intend to ask this witness two or three questions, one of which is the hypothetical question which I think hardly fits the case, but I am going to ask this witness that question, and I think it is proper rebuttal, and for the further reason that these witnesses have attempted to tell Your Honor about the teaching of the profession and I am going to offer [1174] you a witness here that has not only been the president of the National Institution of Cost Accountants, but has taught this subject and has acted as a special adviser not

(Testimony of J. Hugh Jackson.)

only to national undertakings and societies, but has taught this subject. He will, I think, be able to tell Your Honor something as to the teaching and accepted principles of this profession that I did not go into detail with my witnesses and which I consider direct rebuttal to the line of testimony that has been offered by the defendants.

The Court: How many questions did you say?

Mr. Bennett: As soon as he is qualified, I think three questions will cover this.

The Court: Counsel should be in an equal position to offer such rebuttal.

Mr. Bennett: He can if he considers it proper rebuttal.

The Court: Since you have indicated you intend to ask only three questions, I will allow this. However, I think counsel's position is a correct one. Both sides had an opportunity to prepare their cases and offer the expert witnesses in relation to the testimony. As a matter of fact, the Court could limit the expert testimony to one or two expert witnesses on each side. You had a full opportunity to put in the case in chief. There may be something in your mind with relation to what has developed here. That is the reason now that I am allowing you to ask these questions. However, in doing that [1175] counsel may have an equal opportunity if he desires.

Q. (By Mr. Bennett): Will you please state your education, training and experience, and memberships in societies having to do with business ad-

(Testimony of J. Hugh Jackson.)

ministration and accounting, and particularly with reference to any field that has to do with cost accounting?

A. I am a certified public accountant of the states of Massachusetts, Wisconsin and California. I spent nine years in professional accounting with the firm of Price, Waterhouse & Company, two years of which I was in charge of all staff training for that organization throughout North America. I have, for 28 years, been teaching accounting, and most of the years have been teaching cost accounting, and 25 of those years have been as a full professor either at Harvard or Stanford University. I have been a member of the National Association of Cost Accountants practically since its inception. It was organized in September of 1919 and I joined in November of 1919. I have served for two years as president of the San Francisco Chapter, for two years as national vice president, and during 1938-1939 as the national president of the Association. Since that time I have been a member of the research committee of the Association. I have also been past president of the American Accounting Association, which is another national association. I am the author of a number of well known books on accounting. I have served as consultant on accounting and [1176] cost accounting and have installed cost accounting systems for a number of years and in a number of various organizations.

(Testimony of J. Hugh Jackson.)

Mr. Bennett: Now, Your Honor, I am going to ask the witness the question that defense counsel asked of Mr. Farquhar. I want Your Honor to understand, however, that I consider the question in a sense too narrow because I am offering this witness in rebuttal to the specific testimony given by the defendant witnesses. I am going to frame my question as near as I can precisely as it was framed by defendant's counsel.

Mr. Rosenberg: What page of the transcript are you referring to, Mr. Bennett?

Mr. Bennett: Page 1083.

Q. Dean Jackson, I am going to ask you to assume that a chemical plant is recovering from a common raw material three different products, which we will designate as products A, B and C. I will ask you to assume that Product B is technically a by-product in the sense that it contains or consists in part of the chemical element which must be extracted from the raw material in order to produce Product C in the pure and salable form. Assume also that in order to convert part of B into a salable commercial product after it is separated from the raw material, it is necessary to process it, and that for that purpose it is necessary to have a physical plant devoted exclusively to such processing. By that I mean, in the main plant there is special machinery and facilities devoted exclusively to the [1177] production, the grinding, drying and further processing of this byproduct. It is likewise necessary to employ labor which de-

(Testimony of J. Hugh Jackson.)

votes itself exclusively to this processing. Assume further that by reason of contract it is necessary that the manufacturer determine or that there be determined the cost of production of Product B. Will you state in your opinion whether under these circumstances it is proper and good accounting practice to include in the cost of production of product B a portion of the overhead of the whole plant.

Mr. Rosenberg: Now, just for the record, I object to the hypothetical question on the ground it is not proper rebuttal and on the other grounds I have previously stated.

The Court: Objection overruled; exception noted.

Mr. Bennett: Will you read the last part of the question to the witness?

(Record read.)

The Witness: May I, sir, Your Honor, state that it seems to me that there should be the point of view with reference to this whole matter of cost accounting that it is being carried on for the benefit——

Mr. Rosenberg: Just a moment. May we have an answer to the question before the witness dissertates? He has been asked a question and he can answer that yes or no.

The Court: You may answer the question yes or no and then make any explanation you have. Read the question, Mr. [1178] Reporter.

(Record read.)

(Testimony of J. Hugh Jackson.)

The Witness: If you mean by overhead of the entire plant which is not directly allocable to this particular product, my answer would be no.

Q. (By Mr. Bennett): Now, will you state your reason for that, Dean Jackson?

A. My reason for it, that I believe the ordinary business man in dealing with a by-product, will deal with the byproduct on the basis of whether or not the byproduct after it comes off from the main product, and I believe from the discussion that I have heard, that had been more or less agreed that there is no charge to the byproduct material at that point of splitoff. From that time the direct labor, the direct overhead, if you want to use that to determine overhead of the additional plant which would be used in processing that byproduct would be a proper charge to the byproduct. But most business men would not include as a charge to that byproduct that portion of the general overhead which would go on just the same whether the by-product was produced or not. In other words, that product must stand on its own feet as to whether or not it will pay the organization to produce that product from the time it is split off from the main product; and if it will not, any sensible business man would not proceed to produce it.

Q. Do you consider that sound accounting for a situation such [1179] as I mentioned to you?

A. What is sound accounting is that determined by best practices of good businessmen, and that is

(Testimony of J. Hugh Jackson.)

the practice good businessmen would follow. My answer is yes.

Q. If these overhead or indirect charges that you say would not have been incurred if no gypsum, which is the product that I am speaking of here as the byproduct, had been produced in lesser but unascertainable amounts, would you include them or not? A. I think I would not.

Q. If there was a situation where the purchaser of this particular byproduct had a long-term contract where the contract provided a stated price subject to being increased if and when the cost of production of the byproduct increased in excess of 5 per cent over the preceding twelve-month period and the contract provides or the management between the parties provides that the increased price shall not exceed the actual advance in the cost of manufacture of the byproduct in the comparative, state whether or not there would be the same, less or greater reason for the exclusion of certain costs that you have indicated should be excluded?

Mr. Rosenberg: To which I object on the ground it is not the proper subject of expert testimony. It is up to Court to interpret this contract and find out what the rights and obligations of the parties are under the contract.

The Court: Objection sustained. [1180]

The Court: The objection is sustained.

Mr. Bennett: I think I have asked three questions, your Honor, and I will not transgress further.

(Testimony of J. Hugh Jackson.)

Mr. Rosenberg: Where are all the authorities this witness was going to bring? I thought you put him on the stand to educate the court on all these authorities that you mentioned. Isn't that the purpose for which you said you wished to produce this witness?

The Court: I limited counsel to three questions.

Cross-Examination

By Mr. Rosenberg:

Q. Did you train Kenneth Pryor when you were with Price-Waterhouse? Was he one of your proteges there? A. No, sir.

Q. You did not train him? A. No, sir.

Q. If he had fallen into error, that is not your responsibility?

A. I am not responsible for his training, whether he is correct or incorrect.

Q. You mentioned some things you have written. Have you ever written anything on the subject that you have been discussing here this morning?

A. I have not actually written anything, sir, on by-product accounting. I have written on cost accounting.

Q. Not on by-product accounting? [1181]

A. That is correct.

Q. Have you ever written anything in which you took the position that one of a number of products produced in a common plant which requires its own plant equipment and its own labor for the purpose of making it into a commercial

(Testimony of J. Hugh Jackson.)

product, should not be charged with any portion of the overhead of the plant? Did you ever write anything like that?

A. Let me interpret your statement, sir, or ask you what you mean by your term "overhead." I have already said that you would charge the portion of the overhead which is directly allocable to that particular product. But what I was speaking of was in the case of a by-product, where you have certain broad, general overhead—we will say in this particular instance a New York office, in which the expense of the New York office would go on just exactly the same whether the by-product was processed or not—I do not believe that that kind of overhead should be charged to the by-product.

Q. How about the plant superintendent who devotes his time to the production of the so-called by-product, as well as other products of the plant?

A. If the plant superintendent or any other portion of the expense of the plant would go on just the same without the byproduct being there, then I believe most businessmen—and I base this, sir, upon my studies of probably 50 corporations which I have visited in the last two or three years over the [1182] country, as to their practices and procedures—most of them would not include that as part of the cost of the by-product.

Q. So if I understand you correctly, your philosophy is any expense that would continue, even though you discontinued the production of the so-called by-product, should not be included in the cost, is that your philosophy?

(Testimony of J. Hugh Jackson.)

A. That would be my general philosophy, yes, sir.

Q. On what rational basis, Professor, do you distinguish between a by-product and a co-product in arriving at that result?

A. Well, as a good many other people I have heard testify said, it is more or less on an arbitrary basis. You cannot absolutely determine. In a general way, a by-product is a product which is incidental to the manufacture of a main product. You might have two products, both of which were so important that they would be joint products or co-products, because neither one of them takes much precedence over the other. But you might have a number of small products or incidental products which would come off, and which the business would have to determine whether or not, if I may use the figurative expression, they would let the material wash down the sewer or whether they would process it still further, and if they are going to process it still further, then I think that product has got to stand on its own feet and be charged only with the additional expense which would be incurred in the processing of it. [1183]

Q. But as far as superintendence which that particular plant requires, the same as any other product——

A. If you had a separate superintendent or a separate foreman for that particular department, that would be part of your direct overhead.

(Testimony of J. Hugh Jackson.)

Q. But if it is more practical and economical to handle it, we will say, through a general plant superintendent who devotes a portion of his time to the plant in which this so-called by-product is produced, the same as the other products, you would say that it would be improper accounting to allocate a portion of that supervision to the by-product merely because you cannot directly determine the amount of time the superintendent has devoted to the by-product? Is that what I understand?

A. I believe that is true, yes, sir.

Q. Where do you distinguish between a by-product and a co-product? Where is the line of demarcation?

A. As I said a moment ago, sir, that is more or less of an arbitrary matter. Some people take the attitude a product of a certain percentage of value—in other words, if a product is less than, we will say, for the sake of illustration, 10 per cent of the total value, it would be considered a by-product. If it is more than that it might be considered a co-product. I am not saying that is the point of demarcation, but I am saying there is more or less of an arbitrary basis in making that decision. [1184]

Q. At least on that arbitrary basis, if the value of the co-product is 10 per cent or more of the value of the so-called main product, then you would treat it as a co-product for accounting purposes, would you?

(Testimony of J. Hugh Jackson.)

A. I am using 10 per cent just as an arbitrary illustration. If you use that as an arbitrary division point, the answer would be yes.

Q. Didn't you say that that is the position that some people take?

A. No, I said sometimes that is taken.

Q. At least under that theory, if the value of the so-called by-product was 10 per cent or more of the value of the other product, you would treat it under that theory, at least, for accounting purposes, as a co-product, wouldn't you?

A. If I were treating joint products or co-products, both terms being used more or less synonymously, then, of course, you would make your allocation of overhead, general overhead as well as direct overhead, to both products.

Q. Let me ask you, Professor, you have been a member of the NACA since when?

A. Since November, 1919.

Q. Did you take part in that inquiry they had back in July, 1920, or August, 1920, on the subject of by-product accounting? A. No, sir.

Q. Have you ever read it? [1185]

A. Yes, sir, I have read it. I am sure I read it at the time, because I was teaching cost accounting at Harvard at the time, and I have read it more recently, also.

Q. Isn't it a fact at that time the majority of the members of that institute said they favored complete costing of by-products which require proc-

(Testimony of J. Hugh Jackson.)

essing in order to make them salable? Isn't that true?

A. In so far as it is possible to do so without too arbitrary an allocation, but I do not believe, sir, that it stated that general overhead expense of the kind that we are talking about should be charged against the by-product.

Q. Let me ask you this, Professor: Accounting is supposed to be a rational science, isn't it?

A. It is supposed to be good common sense.

Q. It is supposed to be good common sense?

A. That is right.

Q. If you have a plant that is making ten products, and I will let you put them all in the category of co-products, it is perfectly proper under those circumstances to allocate plant overhead of the kind you and I have been talking about among the ten products, isn't it?

A. Well, if you had ten co-products—I could not conceive of ten co-products.

Q. Let us get down to four.

A. If you had two or three, we will say, that were major co-products, [1186] then on some arbitrary basis or other you would make the allocation, yourself.

Q. Let us make it four. Now, if you are making four co-products you allocate the plant overhead among those four products, don't you?

A. That would be correct.

Q. That would be good accounting practice?

A. I think that would be.

(Testimony of J. Hugh Jackson.)

Q. The fact remains if you discontinued one, the overhead would continue just the same, but in some lesser amount?

A. It might continue in some lesser amount; it might not.

Q. You can answer that just as accurately as you can answer the question if one of those products was, as you term, a by-product, whether the overhead would continue as to that by-product: You do not have any dispute there, do you?

A. The difference, however, sir, is in the case of co-products, the co-products are all co-products in your general scheme of manufacturing, whereas your by-product is a purely incidental thing.

Q. You mean you can't help it?

A. That is right. It can be waste or not, and you have to make the decision afterwards as to whether or not you continue to produce them, whether you go ahead and make that by-product a salable product, or not.

Q. Of course, you do not know whether the product we are talking [1187] about in this case is a by-product, do you?

A. I do not know very much about the particular case, sir. I am talking only in general principles.

Q. In other words, you are just assuming a typical by-product, aren't you?

A. That is correct.

Q. And, of course, in the case of a typical by-product, the amount of by-product that you get depends and is incidental to the amount of main product you produce, isn't it?

(Testimony of J. Hugh Jackson.)

A. It comes off as a natural result of the production of your main product at a split-off point. The decision has to be made there as to whether you will proceed to process it further or not.

Q. What I say is true, isn't it, that the amount of by-product that you get, the by-product material, depends upon the amount of the main product that you produce, isn't that true?

A. Yes, at the split-off point.

Q. And if you found that you were producing in the plant the maximum of product A and you were not producing the maximum of product B, you would not call product A a by-product of product B, would you?

A. You mean in the hypothetical question that was asked?

Q. Yes.

A. Well, I think the assumption was made there that product A was your main product. [1188]

Q. Forget that hypothesis. Let us start with a new one. You have a chemical plant where you are using a common raw material, and you take out a chemical element A. You process that and make a finished product, and then the raw material goes on and you process that and you make a product B, and if you found out that in this plant you were making the maximum of product A that could be taken out of the raw material, but you were not making the maximum of product B, you certainly would not say that product A was a by-product of product B, would you?

(Testimony of J. Hugh Jackson.)

A. No, I do not think you ordinarily would.

Q. You said you heard there was no charge made in this case prior to the point of separation. Where did you get that information?

A. I am sorry if I said that. I did not realize I said it in this case. I said I thought that was the general rule with reference to the split-off point for by-products, that no charge was made at the split-off point for the by-product.

Q. You were not purporting to speak subjectively as to this case, then?

A. I know nothing about this particular instance.

Q. When were you first contacted about testifying in this case?

A. Do you want me to tell exactly what the situation was?

Q. No, I am just asking you approximately when the plaintiff first contacted you.

Mr. Bennett: I would be willing to let him state what [1189] the situation was.

Mr. Rosenberg: Mr. Bennett, I did not bother you on direct. Leave me alone for a minute.

The Witness: I am contacted——

Q. (By Mr. Rosenberg): Just when, Doctor?

A. Let me think. I am not absolutely sure about it, whether it was—let's see. This is Friday. About Thursday or Friday of last week. One afternoon I was called on the telephone, and in the evening of the same day, sir, you called me.

(Testimony of J. Hugh Jackson.)

Q. You already had been contacted and were available for testimony at that time, weren't you?

A. That is correct.

Q. That is just what I wanted to develop.

Mr. Bennett: I did not like that last statement of yours. I think it was an unfair left-hand dig at the witness that is going to force me to ask him more questions about that, Counsel. I assume you imply this witness is willing to sell himself.

Mr. Rosenberg: No, I did not mean that, at all.

The Court: I just informed myself from the witness, while you gentlemen were quarreling, that he did not consider anything that has occurred a dig, at all.

Mr. Rosenberg: I can assure the witness, your Honor, I did not mean to imply the thing Mr. Bennett thought I did. If I gave that impression, Professor, I want to apologize.

The Witness: I stated to Mr. Rosenberg I felt an expert [1190] witness' testimony would be approximately the same whichever side he testified for. Isn't that what I stated to you over the phone?

Mr. Rosenberg: Yes.

The Witness: In other words, I would tell the truth as I saw it with reference to the scientific aspects of the subject.

Q. (By Mr. Rosenberg): Will you tell me, Doctor, can you refer me to any authority that you have come in contact with in your capacity at Stanford University that you consider authoritative, in which it is stated that where you have product

(Testimony of J. Hugh Jackson.)

that is designated as a by-product, which requires physical plant and direct labor to make it a salable, merchantable product, that it is improper in determining the cost of production of that product to include anything other than direct labor and material cost. Can you refer me to any authority?

A. No, sir. Now, wait a minute.

Q. All right. I will go ahead with you. And overhead expense that is directly allocable to that product.

A. Yes, all additional overhead that would be incurred specifically for that product.

Q. You do not have to allocate that, do you?

A. No. Well, you might do so on a tonnage basis, or some such thing as that.

Q. You mean to determine unit cost?

A. Yes, unit cost. [1191]

Q. But as far as the aggregate production of the product is concerned, there is no allocation problem involved, is there?

A. That is correct.

Q. What I am asking you to tell me is if you can refer me to any authority in which it is stated that because you designate a product as a by-product, and it being a product which requires a physical plant and direct labor to make it into a merchantable product, it is improper to allocate any overhead expense to that product: Can you refer me to any authority on that?

A. I do not know, sir, that I could quote at the moment any one of the authorities on cost account-

(Testimony of J. Hugh Jackson.)

ing that specifically state that. I think, however, sir, there are statements of that kind appearing in cost literature, but I could not name the specific——

Q. Didn't Mr. Bennett ask you? He implied to the court that that was the purpose for which he brought you here. Didn't he tell you to come with any authority you had to sustain your position?

A. No, not with reference to——

Q. Have you ever heard of Cannan?

A. I know Eric Cannan very well. He is a good friend of mine.

Q. He is recognized as a good cost accountant?

A. Yes.

Q. Have you ever read his book? [1192]

A. Yes, sir.

Q. Doesn't Mr. Cannan say that to take a product which comes out of a plant and which requires a physical plant and requires labor, to apply the term "by-product" to that and treat it as a by-product results in superficial accounting? Isn't that what he says?

A. I couldn't answer your question, sir.

Q. Maybe I can help you. Just read that paragraph.

A. I do not see anything in that statement, sir, which would say that he feels that the elimination of broad general overhead would be an incorrect basis of accounting.

Q. Wouldn't you construe this to be an expression of his opinion that you treat a by-product the same as a co-product?

(Testimony of J. Hugh Jackson.)

A. He says it sometimes leads to superficial accounting if you do not do that.

Q. What do you think he meant when he said this, Professor:

“The word ‘by-product’ is a troublesome thing. Frequently by-products are of considerable value. They may even be worth more than the so-called main products from which they derive. The implication in the word ‘by-product’ that a by-product is merely nominal because it is incidental to the obtainment of some other may lead to superficial accounting treatment? Such products are better regarded as joint products, differing, it is true, in importance and value as well as nature, but nevertheless [1193] meriting equal consideration as products.”

Don't you construe that to mean that they should be treated in the same manner as you treat co-products?

A. Let me say this to you: If the statement there which he makes that the by-product is worth more or might be worth more than the main product is true, then it would cease to be a by-product.

Q. You will concede, Professor, when a man is talking about by-products, a man such as Mr. Cannan, he knows what he is talking about?

A. I would say he knows as much about it as the ordinary cost accountant.

Q. Maybe a little more than the average?

A. He is recognized as one of the authorities, of course.

(Testimony of J. Hugh Jackson.)

Q. So when he says, "Such products (and he is talking about by-products) are better regarded as joint products, differing, it is true, in importance and value as well as nature, but nevertheless meriting equal consideration as products," don't you construe that to mean that it is Mr. Cannan's opinion a by-product should be treated for accounting purposes in the same manner as you would treat a co-product?

A. I would think that is what Mr. Cannan means, where you have a by-product, but that would not necessarily mean all authorities would agree with him on that.

Q. I do not say that. [1194] A. Yes.

Q. Getting back to this publication by the NACA, you recall that this paper speaks of three different methods of by-products accounting; do you recall that? A. Yes, sir.

Q. And the last method is what they call the total cost method, is that right? Do you recall that?

A. Yes.

Q. And under the third method there it speaks of an equitable—what does it say?

A. An equitable proportion of overhead.

Q. Naturally that means an allocative portion of overhead, doesn't it?

A. I would not necessarily think so, sir.

Q. What would an equitable portion be? If it were direct overhead of a separate plant devoted to the by-product it would not be an equitable proportion, would it? It would be overhead?

(Testimony of J. Hugh Jackson.)

A. I think it might be.

Q. You think it would?

A. I think it might very definitely be.

Q. What do you construe this to be, an equitable portion, if it was allocated? What do you think that means?

A. I think that means, sir—and perhaps I do not go as strongly on that as some people because two out of the three men who [1195] constitute that department are former students of mine—

Q. Can you say that?

A. Two out of the three men who operate the research department of the NACA are former students of mine.

Q. And they were back in 1920, were they?

A. I could not be sure about that. I know not both of them, because one of them has graduated since. One of them went from Harvard at that time. But I think when they simply say an equitable proportion of overhead they mean a proportion of overhead that would be recognized on the basis of what we would commonly call allocating to a joint product or a by-product, and that does not necessarily mean at all, sir, that you are going to put this general overhead on the by-product.

Q. But, Professor, you spoke of allocating general overhead to a by-product. I thought that was

(Testimony of J. Hugh Jackson.)

never done. A. I said I would not do it.

Q. But you will concede that there is reputable authority that feels that is proper?

A. I think that some writers would say yes, surely. You had a witness on the stand who said that.

Q. Let us not confine it to such small numbers. You would go a little further than that, wouldn't you? There is a school of thought in accounting that feels that where a product gets out of the category of waste or scrap, for accounting purposes it is proper to treat it the same as you do a co-product, isn't [1196] that true?

A. I think there are some who would say that, yes. But I still say that the general—in my opinion, at least, the best accountants and those who are thinkers on this subject would say that the overhead which would continue on should not be allocated to the by-product.

Q. Then that school of thought are not in favor of anything but direct charges, are they?

A. That is correct.

Q. There is a school of thought that do not even cost account by-products, isn't that true? As a matter of convenience and expediency it is very common practice not even to cost account by-products, isn't it?

A. I suppose you would say that. You mean by that those who simply sell the by-products for what

(Testimony of J. Hugh Jackson.)

they can get for them and credit the selling price to the main product?

Q. That is very common?

A. Yes, that is very common procedure.

Q. But it does not result in determination of cost, does it?

A. No, that does not necessarily mean, and it usually does not mean that.

Q. The reason you do that, in the last analysis, is that it is an expedient thing to do?

A. The same reason for which we use the straight line depreciation so frequently. [1197]

Q. It is an expedient thing to do?

A. An expedient thing to do.

Q. Have you ever read Neuner on Cost Accounting?

A. I have a copy of it. I have read some sections out of it. I have not read the whole volume, no.

Q. Have you read the chapter that deals with by-products accounting?

A. I do not think I have.

Q. So you are not familiar with that?

A. I do not think I am familiar with that particular chapter. There are so many of these books coming out all the time you can't read all of them.

Q. That is part of your function as dean of the business school down there, to keep abreast of these things?

A. That is one of my small parts of my function.

Q. How long is it since you set up cost accounting for any concern?

(Testimony of J. Hugh Jackson.)

Mr. Bennett: You mean actually in profession?

Q. (Mr. Rosenberg): Professionally.

A. Well, of course, my work has not been so much, sir, of going in and actually setting up a cost accounting system as advising the existing people with reference to their cost accounting system, and I am doing that more or less constantly all the time, sir. I do not think I should necessarily name specific people that I have done that for, or anything of that kind. [1198]

Q. No. You say you are familiar with this book by Neuner, are you?

A. I have a copy of it on my shelf.

Q. Who is Neuner? Is he anyone of any authority?

A. I could not answer your question at the moment. I forget the organization he is associated with. I do not happen to know him personally, at all.

Q. At least you will concede it is not uncommon, is it, Professor, to record the cost of a by-product before and after separation from the main product and to treat it for accounting purposes the same as a co-product?

Mr. Bennett: Why go into that? You people treated this yourself in such a way that you do not charge processing prior to the point of separation.

Mr. Rosenberg: That is about the fifth time Mr. Bennett has said that and there is not a particle of evidence in this record that there is any cost prior to the point of separation.

(Testimony of J. Hugh Jackson.)

Mr. Bennett: There is cost.

Mr. Rosenberg: What is it?

Mr. Bennett: You would be charging the cost from the time you get the bittern.

Mr. Rosenberg: We do.

Mr. Bennett: No, you do not.

Mr. Rosenberg: We do not? [1199]

Mr. Bennett: You stated here in your opening statement, and your witnesses have, up to the point of separation of the calcium sulphate you charge no processing charges against gypsum.

Mr. Rosenberg: Because there is no processing charge.

Mr. Bennett: There is the handling of the fluid in the holding ponds, pumping into settling tanks.

Mr. Rosenberg: Oh, no. You recall Mr. Watt's testimony. That is one of the reasons the bittern charge went up one time, because the cost of the pumping of bittern went up, and we are charging it with the raw material.

Mr. Bennett: He said he made an arbitrary charge, but you, yourself, stated there was no processing charge up to the point of separation.

Mr. Rosenberg: Maybe that was the one instance I made a mistake in this case. No further questions.

Mr. Bennett: That is all. Thank you, Professor. Your Honor, I have one lone witness.

The Court: Call him.

WILLIAM R. KLECKNER,

called as a witness on behalf of Plaintiff in Rebuttal; sworn

Q. (The Clerk): Your name?

A. William R. Kleckner.

Direct Examination

Q. (Mr. Bennett): Will you state your present occupation, [1200] Mr. Kleckner?

A. I am chief chemist of the Cement Division of the Pacific Portland Cement Company.

Q. How long have you been such?

A. I have been in that position during the past five or six years.

The Court: May I inquire, for the purpose of the record, what is the purpose of this testimony?

Mr. Bennett: To show by this witness—and I can show by one or two questions after I have finished his qualifications—this sulphuric acid, which your Honor recalls during the last period was suddenly added to the cost of gypsum, and which had never been charged before, is not used solely for the production of gypsum, but its main purpose is for the production of magnesium oxide, and therefore it is not proper to include sulphuric acid as a charge against gypsum.

The Court: How many questions did you say?

Mr. Bennett: I think three questions after he finishes his qualifications. I will try to hold myself to that magic three.

The Court: I have tried diligently, with all the energy I have had, to minimize in some fashion

(Testimony of William R. Kleckner.)

our prolonged hearing here, but I have failed, and now that we have gone thus far, if you have only three questions I will yield.

Q. (Mr. Bennett): State your education and training as a [1201] chemist, Mr. Kleckner?

A. I graduated from a chemical course in 1904 at Muhlerberg College, Pennsylvania, and took a one-year course in metallurgy and assaying at Lehigh University, Bethlehem, Pennsylvania, and two years later I became chief chemist of the Heikle Cement Plant at Bay City, Michigan, and since then I have been employed almost continuously as either a consultant chief chemist or directing chief chemist of cement plants in California, and I have been called as a consultant on iodine plants, and I have also prepared processes; at least one distinctive process for the War Department in February of 1942 for the manufacture of magnesia as well as a continuation with the magnesia extracts to the point of making metallic magnesia which was approved by the War Department and their board of consulting chemists. [1202]

Q. Have you made any study or experiments with reference to the production of magnesium oxide and gypsum from bittern in any way in which the use of sulphuric acid has been employed?

A. Yes.

Q. Have you made specific laboratory tests on those?

A. I have.

Q. As a result of those tests and your training and experience, I ask you, if in your opinion

(Testimony of William R. Kleckner.)

whether or not in the manufacture of magnesium oxide as a primary product and where it is at the stage shown on this chart, Plaintiff's Exhibit 16 for identification, calcium sulphate is precipitated off or taken off, whether the addition of sulphuric acid prior to the separation of the sulphate from the bittern water furthers the manufacture and recovery of the magnesium oxide.

A. Yes, it does.

Q. In your experience and as a result of your knowledge and experience, would you say in the addition of sulphuric acid prior to any taking off of the calcium sulphate, whether the purpose of that sulphuric acid is for the efficient processing or taking off of magnesium oxide——

A. For the magnesium oxide?

Q. Does the addition of the sulphuric acid affect in any noticeable or material way either the precipitation or formation of gypsum crystals?

A. No, it does not. [1203]

Mr. Bennett: You may cross-examine.

Cross-Examination

Q. (Mr. Rosenberg): When did you conduct these tests, Mr. Kleckner?

A. I have conducted tests on sea water and the constituents contained in sea water over a period of years. In our Redwood City plant we are very much concerned about sea water for the reason that we use hundreds of thousands of gallons of sea water every day and we also have in one of our recovery departments considerable salts derived from sea

(Testimony of William R. Kleckner.)

water. These naturally have been the object of my attention for the purpose of recovering them in a commercial way and to put them on the market and sell them for a price that would net the company some extra values.

Q. Are you familiar with the Permanente Company plant at Moss Landing? A. Yes.

Q. They recover magnesium oxide there, don't they? A. Yes.

Q. Do they use sulphuric acid?

A. That is more than I can say. I don't know whether they do.

Q. Don't you know for a fact they do not?

A. As a matter of fact, the reason I so state was that I made no definite inquiries at the Moss Landing plant as to whether or not they did or did not. [1204]

Q. Have you been down there?

A. Yes, I have been through there.

Q. Have you inspected their processes?

A. Well, yes.

Q. But you didn't find out whether they were using sulphuric acid? A. No.

Q. When you conducted these tests or experiments that you have mentioned, was it determined that sulphuric acid is essential to the production of magnesium oxide?

A. Those tests and determinations were made over a period of a number of years and again I repeated, during the last few months, to check up very definitely upon the propriety of adding sul-

(Testimony of William R. Kleckner.)

phuric acid or omitting it in the preparation of the magnesium hydroxide precipitate.

Q. Where was the test conducted? In the laboratory?

A. The test was conducted partly at Redwood and partly at the San Juan cement plant.

Q. But not in a plant in the actual production of gypsum? A. No.

Q. You don't have any facilities at that plant for gypsum, do you?

A. No, we are not manufacturing gypsum on a commercial basis.

Q. Did you make any tests without adding sulphuric acid and precipitating the calcium sulphate? [1205] A. Certainly.

Q. You say that the crystals were identical to those that you precipitate when you use sulphuric acid? A. Correct.

Q. No difference in size or shape?

A. The gypsum crystal is monoclinic and it is true that no precipitation of chemical substance—they will have a certain gradation of large, medium and small crystals depending on the rate of crystallization.

Q. Well,—

A. But on comparative studies on the same bittern using sulphuric acid in one case, and leaving it out in another case, in the precipitation of the gypsum, the crystals were all the same size and all of the monoclinical type.

Q. You had no opportunity to run them through

(Testimony of William R. Kleckner.)

a commercial filter plant to see if they would react differently in a filter plant?

A. No, naturally not.

Mr. Rosenberg: That's all.

Redirect Examination

Q. (Mr. Bennett): They don't manufacture any magnesia products at the Permanente plant at Moss Landing out of bittern, do they?

A. No, they manufacture magnesia out of sea water.

Q. Would there be a different effect on the purpose and use of [1206] sulphuric acid in the case of bittern than there would be in sea water?

A. Yes, if you propose to manufacture magnesia hydroxide out of bittern.

Q. Why does it have the effect you say it does on magnesia, Mr. Kleckner?

A. The distinction must be kept in mind that at Moss Landing they are drawing their raw material which is ocean water directly from the ocean; whereas bittern is a very complicated or complex solution consisting of the contamination of a great number of things resulting from the evaporation of sea water and includes both the chemical constituents that are derived from algae as well as decayed matter and sewage that is naturally dumped into the lower end of the Bay. Now, the sulphuric acid addition will counteract the colloids and the mucilaginous materials derived from the algae and will produce a magnesium oxide precipitate that will be highly dispersed, settle very slowly and go

(Testimony of William R. Kleckner.)

into a colloidal or gelatinous state very rapidly. But with the addition of the sulphuric acid to the bittern, a remarkable change takes place in that the magnesium oxide becomes a crystallant rhomborhedral, tabular crystals would settle fast and are of high purity; in fact, maximum purity.

Q. You wouldn't get that condition so far as the magnesium oxide is concerned unless you would use the sulphuric or some other acid? [1207]

A. That's right.

Mr. Bennett: That's all.

Recross-Examination

Q. (Mr. Rosenberg): In the tests or experiments that you made, did you use bittern?

A. Yes.

Redirect Examination

Q. (Mr. Bennett): Where did you get the bittern?

A. I got the bittern out of one of the Westvaco storage tanks.

Mr. Rosenberg: I am glad you brought that out, Mr. Bennett.

The Court: Step down.

Mr. Rosenberg: I have just one other question, Your Honor.

The Court: Very well.

Recross-Examination

Q. (Mr. Rosenberg): What is the function that sulphuric acid plays in the production of magnesium oxide? Would you explain that, because I did not understand it.

(Testimony of William R. Kleckner.)

Mr. Bennett: He already answered that. He gave his answer.

Mr. Rosenberg: I believe you are right.

The Witness: But in addition to that, it does produce the albuminoids from the amino-acids.

Mr. Bennett: I am about to close and I ask at this time that the following portions of the defendant's answers to the [1208] plaintiff's interrogatories which are on file, be admitted in evidence and deemed read and the Reporter can include in his record. I don't think Your Honor needs to have them read now. We will ask they be admitted and deemed read.

Mr. Rosenberg: I am going to object to anything being read into the record at this time. This is not proper rebuttal. I don't know what counsel is talking about, but I submit at this time it is highly improper to ask that anything be admitted in evidence that is not strictly rebuttal evidence.

Mr. Bennett: How could the defendants be hurt by any admissions they have made?

The Court: Those are matters of record, are they not?

Mr. Rosenberg: I don't think they are matters of record. I think they are in the same category as depositions. They may or may not be used.

The Court: What I had in mind was this: I think I tried to indicate that I permitted abuses that I had no question in my mind about in relation to the trial of this case. However, in the first place, I was going into a strange field and I allowed the widest latitude for that reason. But to come

along now at this hour and at this time dig up the record here in relation to the subject matter therein contained and offered without opportunity of the other side meeting it——

Mr. Bennett: If I may interrupt, Your Honor, how can there be any possible prejudice? All I am offering is what they have [1209] admitted in their interrogatories. As I have told Your Honor before, and I say this respectfully, the burden of proof rests on the defendant after we have shown the controversy, because they have the affirmative of showing the propriety of the price increase.

The Court: I am not prepared to say that. You may deal with that phase of the matter in your brief. I say that so you will have the benefit of my state of mind.

Mr. Bennett: Your Honor, I can not conceive of where at this juncture there could be any claim of any conceivable prejudice. All we want to offer at this time, in addition to this chart which has been identified and referred to in the evidence by a number of witnesses, are certain of these admissions that the defendants have made in their interrogatories. Obviously no prejudice can come from that. They know what they said, and they probably took plenty of time, too. The evidence shows Mr. Watt collaborated in those answers——

The Court: Both of you did much in the way of collaboration. I hold you both equally guilty on that score. Do you insist upon your objection?

Mr. Rosenberg: Yes, Your Honor. I say the interrogatories are in the same category as the

depositions. If the occasion arises during the course of the trial to use depositions, it is perfectly proper, and it can be done at the proper time. It is true that I am perfectly willing to be bound by anything in our [1210] answers except where it may develop through testimony introduced here that someone else knew more about the subject than the attorney or accountant who collaborated in getting out those answers.

The Court: I am prepared to indicate to you that you can get together, if you can, so both sides may have full and equal opportunity.

Mr. Bennett: The only thing is, we want to refer to certain admissions that the defendants made in their interrogatories, in preparing our brief.

Mr. Rosenberg: I think that about demonstrates the basis of the objection. Here they have finished their case in chief and their rebuttal testimony and now when the case is all over they want to bind us to some admissions. I don't know what they are. Maybe they are responsive to questions, but maybe they are not completely responsive.

The Court: Gentlemen, I am prepared to rule now.

Mr. Bennett: Don't you think, Your Honor, I should make it clear what I have offered?

The Court: You may.

Mr. Bennett: I have already indicated, or intended to indicate, Exhibit D; also the answers in No. 9G, the answers in No. 10G.

The Court: I will adjourn this case until 2:30 this afternoon so both sides may get together on this and indicate what you wish to do.

(Whereupon an adjournment was taken until 2:30 p.m.) [1211]

Friday, January 2, 1948, 2:00 o'clock p.m.

Mr. Rosenberg: If our Honor please, when we adjourned we were discussing the answers to the interrogatories. As I stated at that time, I do not think that they are admissible as evidence in rebuttal. However, I have no objection to them going in except to state that I would expect that they would be considered in the light of the testimony that may have gone into the record on specific subjects. I do not know whether there is anything inconsistent with those answers and the testimony that may have gone into the record. The evidence shows they were prepared by me with the assistance of Mr. Watt. Some of them dealt with some subjects where some of the technical testimony was slightly different. I do not know that to be the case, but I would have no objection to them being considered under those circumstances.

Mr. Bennett: Your Honor, so the record will be clear, I will offer at this time as admissions and for the purpose of showing contentions made by the defendant, the following interrogatories by the plaintiff and the answers thereto as appears from the interrogatories and answers on file with the Court, and ask that the same be deemed read and the Reporter may write them into the transcript.

No. 6G, Exhibit C; No. 9G; No. 10G; No. 11; No. 19; No. 20. There are other answers and interrogatories that I think [1212] have already been admitted in addition to those, Your Honor.

(The interrogatories and answers referred to are as follows:)

“6(G). State in what particulars and to what extent each element of such cost as determined by defendant for each of said periods ended June 30, 1940, and June 30, 1941, respectively, contributed to or was related to the production of gypsum. State whether each element would have been incurred if no gypsum had been produced.

“Answer: See Exhibit ‘C’ attached hereto. None of the direct charges shown on Exhibit C would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit C would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts.

	July 1, 1940 June 30, 1941	July 1, 1939 June 30, 1940	
(a)	\$1.84	\$1.66	
(b) Labor—Operations	.19	.19	Actual time card dist.
Labor—Repairs	.13	.11	Actual time card dist.
Comp. Ins. & S.S. Taxes	.02	.02	Follows labor
Materials—Operations	.02	.01	S'room req. & Direct purch.
Materials—Repairs	.21	.10	S'room req. & Direct purch.
Bittern (1)	.14	.10	Arbitrary allocation
Water	.01	.04	At cost—measured
Power	.13	.11	At cost—measured
Gas	.09	.11	At cost—measured
Fuel Oil	.00	.00	At cost—measured
Overhead (2)	.35	.29	Allocated—Labor
Taxes, Ins. & Depre.(3)	.38	.37	Allocated— $\frac{7}{8}$ roughly based on plant value
Interdept. Charges	.00	.01	At cost
Ship. Expense (4)	.18	.19	Actual cost plus pro-rate of Misc. Ship. Exp.
(c) (1) Gypsum	.14	.10	per ton

	July 1, 1940	July 1, 1939
	June 30, 1941	June 30, 1940
Bromine	25.40	17.80 per ton
Magnesia	.67	.52 per ton
(2) Gypsum	7.2%	7.1%
Service Accounts	3.0%	3.9%
Lime	9.5%	12.6%
EthyleneDibromide	23.9%	28.8%
Magnesia	56.4%	47.6%
(3) Gypsum	7.6%	7.4%
Service Accounts	3.0%	2.9%
Lime	30.4%	31.0%
EthyleneDibromide	21.3%	23.8%
Magnesia	37.7%	34.9%
(4) Gypsum	6.0%	8.9%
EthyleneDibromide	18.2%	19.0%
Lime	3.6%	9.7%
Magnesia	72.2%	62.4%

“Interrogatory No. 9(G). State the facts called for interrogatory 6(F) as incorporated in this interrogatory 9, if defendant’s cost per ton of production of gypsum as calculated by defendant for the 12-month period ended December 31, 1943, contained any element of cost not included in such cost as determined for the 12-month period ended December 31, 1942, or for either of the aforesaid periods ended June 30, 1940, and June 30, 1941, respectively; or if such costs as calculated by defendant for the twelve-month period ended December 31, 1942, contained any element of cost not included in such cost as determined for either of the aforesaid periods ended June 30, 1940, and June 30, 1941, respectively”;

“Answer 9(G). See Exhibit ‘E’ attached hereto. None of the direct charges shown on Exhibit E

would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit E would have been incurred if no gypsum had been produced but in lesser and unascertainable amounts.

EXHIBIT E

	Year	Year	
	1943	1942	
(a)	\$2.71	\$1.93	
(b) Labor—Operations	.39	.26	Actual time card dist.
Labor—Repairs	.16	.12	Actual time card dist.
Comp. Ins. & S.S. Taxes	.03	.02	Follows Labor
Materials—Operations	.02	....	S'room req. & Direct Purch.
Materials—Repairs	.07	.06	S'room req. & Direct Purch.
Bittern (1)	.20	.20	Arbitrary Allocation
Water	.01	....	At cost—measured
Power	.18	.15	At cost—measured
Fuel	.14	.10	At cost—measured
Overhead (2)	.82	.42	Allocated—Labor basis
Taxes, Ins. & Depr. (3)	.49	.41	Allocated—% roughly based on plant value
Inter-departmental charges	.01	....	At cost
Ship. Expense (4)	.19	.10	Actual cost plus pro-rate of Misc. Ship. Expense
(c) (1) Gypsum	.20	.20	per ton
Bromine	16.60	15.80	per ton
Magnesia	1.11	.96	per ton
(2) Gypsum	5.3%	5.0%	
Service Accounts	2.7%	2.9%	
Lime	11.6%	7.9%	
Ethylene Dibromide	17.1%	16.3%	
Magnesia	63.3%	67.9%	
(3) Gypsum	8.1%	7.1%	
Service Accounts	2.2%	2.1%	
Lime	25.2%	23.3%	
Ethylene Dibromide	11.2%	18.7%	
Magnesia	53.3%	48.8%	

(4) Gypsum	3.7%	6.2%
Lime	11.1%	14.7%
Ethylene Dibromide	4.6%	4.8%
Magnesia	30.6%	71.3%

“Interrogatory 10(G). State the facts called for by interrogatory 6(F) as incorporated in this interrogatory 10 if defendant’s cost per ton of production of gypsum as calculated by defendant for the twelve-month period ended June 30, 1946, contained any element of cost not included in such cost as determined for the 12-month period ended June 30, 1945, or for either of the aforesaid periods ended December 31, 1942, and December 31, 1943, respectively; or if such cost as calculated by defendant for the twelve-month period ended June 30, 1945, contained any element of cost not included in such cost as determined for either of the aforesaid periods ended December 31, 1942, and December 31, 1943, respectively.”

“Answer 10(G). See Exhibit ‘F’ attached hereto. None of the direct charges shown on Exhibit F would have been incurred if no gypsum had been produced. Indirect charges shown on Exhibit F would have been incurred if no gypsum had been produced, but in lesser and unascertainable amounts.”

EXHIBIT F

		July 1, 1944	July 1, 1945
		June 30, 1945	June 30, 1946
(a)		\$2.52	\$3.24
(b)	Supervision (5)	.04	.04 Allocated
	Labor-Operations	.32	.35 Actual time card dist.
	Labor-Repairs	.21	.25 Actual time card dist.

Materials-Operations	.02	.05	S'room req. & Direct Purch.
Materials-Repairs	.11	.20	S'room req. & Direct Purch.
Bittern (1)	.18	.16	Arbitrary Allocation
Water	.02	.02	At cost—measured
Power	.14	.14	At cost—measured
Gas	.10	.11	At cost—measured
Fuel Oil	....	.01	At cost—measured
Sulphuric Acid	....	.35	At cost—measured
Overhead (2)	.74	.38	Allocated—labor basis
Taxes, Ins., Depr. (3)	.42	.39	Allocated—% roughly based on Plant value
Inter-depart- mental charges	.01	.01	At cost
Ship. Expense (4)	.21	.28	Actual cost plus pro-rate Misc. Ship. Exp.
(c) (1) Gypsum	.18	.16	per ton
Bromine	12.75	13.29	per ton
Magnesia	.72	.73	per ton
(2) Gypsum	6.3%	7.8%	
Service Accounts	1.9%	3.1%	
Lime	8.9%	9.1%	
Ethylene Dibro- mide	12.3%	6.3%	
Magnesia	70.1%	73.4%	
(3) Gypsum	9.0%	9.6%	
Service Accounts	4.1%	3.6%	
Lime	26.3%	26.8%	
Eythlene Dibro- mide	12.5%	10.1%	
Magnesia	48.1%	49.9%	
(4) Gypsum	24.0%	46.7%	
Ethlyne Dibro- mide	4.0%	0.5%	
Lime	6.4%	4.5%	
Magnesia	65.6%	48.3%	
(5) Gypsum	18.8%	26.0%	
Ethylene Dibro- mide	2.3%	1.1%	
Lime	6.3%	6.0%	
Magnesia	72.6%	66.9%	

“Interrogatory 11. State the character and general subject matter of the books and records of defendants and of the entries therein that are claimed by defendant to be of a confidential and secretive nature or trade secrets, as alleged in lines 7 to 12, page 4 of defendant’s answers; and state wherein said books, records and entries are confidential and secretive and wherein they are trade secrets. Identify said books and records with particularity and state in what individual’s custody and at what place they are now kept.

“Answer 11. Answering Interrogatory No. 11, defendant states that the entries which are claimed by defendant to be of a confidential and secretive nature and to constitute trade secrets are the entries showing the bittern royalties paid by defendant to its supplier, Leslie Salt Company, which entries are contained in the general ledger, production ledger, sales ledger and sundry reports derived therefrom. Said entries [1219] with reference to the bittern royalties are deemed to be confidential, secretive and to constitute trade secrets because to make the desired disclosure would involve disclosure of the terms and conditions of a material contract between said supplier and defendant and inspection of said contract and the payments made thereunder would disclose all the products made by defendant, and the quantities sold. Disclosure thereof would require defendant also to reveal detailed information with reference to all products sold by defendant, including the identity and quantity of such products. Likewise,

defendant has bittern contracts with other producers and the disclosure of the terms and conditions of its bittern contract with Leslie Salt Company might jeopardize the present and future relations of defendant with such other producers.

“Likewise, defendant claims that its books, records and entries showing the bases for allocation of shipping expense are likewise confidential and comprise trade secrets for the reason that disclosure of said information would reveal the products sold by defendant and the quantities and selling prices thereof. The general ledger, which contains the entries above referred to are located in defendant’s plant at Newark, California, and are in the custody of Mr. David Watt, the office manager of defendant.” [1220]

“Interrogatory No. 19. State whether or not defendant discontinued the production of ethylene-dibromide in or about October 1945. If such production was discontinued, state what proportion of the total overhead of defendant’s Newark, California, plant (including taxes, insurance, depreciation and indirect costs of water and steam) was charged or allocated to said product and to each other product produced at said plant for each of defendant’s accounting periods during the time when ethylene-dibromide was being produced at this plant; and state the method or manner, including the accounting principles or procedures, of allocating to other products the proportion of total overhead formerly allocated to ethylene-dibromide that was adopted by defendant upon such discontinu-

ance. State what proportion of such total overhead was allocated to each other product produced at the Newark, California plant during the period of the discontinuance of production of ethylene-dibromide to June 30, 1946.

“Answer: Answering Interrogatory No. 19, defendant states that it did discontinue the production of ethylene-dibromide on or about September 16, 1945. During the period that ethylene-dibromide was being produced, overhead was charged thereto in the amounts shown in Exhibits ‘B’, ‘C’, ‘E’ and ‘F’ attached hereto. Upon discontinuance of production of ethylene-dibromide the general overhead formerly charged thereto was allocated among the other products produced by defendant, on an operating [1221] and repair labor basis. As to what proportion of the total overhead formerly charged to ethylene-dibromide was, upon discontinuance of the production thereof, allocated to the various other products produced by defendant at Newark, California, such information is not available because it is not set up on the books of defendant and cannot be computed, because to make such computation would require the actual knowledge of the cost of production of various elements of cost involved in producing a product which was not produced.”

“Interrogatory No. 20. If the cost of sulphuric acid is now charged or allocated in whole or in part by defendant to the cost of production of gypsum, state in what respect the use of sulphuric acid is necessary to or contributes to the production

of gypsum, and state whether, and to what extent, the use of sulphuric acid contributes to the production, or was or is used in the manufacture or production by defendant, of any other product or products produced at defendant's Newark, California plant."

"Answer. Answering Interrogatory No. 20, defendant states that sulphuric acid is necessary in the production of gypsum because the pH of the bittern is too high to permit of proper precipitation of gypsum from the bittern, and thus sulphuric acid is added to the bittern to lower the pH to a point where separation of gypsum from the bittern is possible. A large [1222] proportion of the sulphuric acid added is incorporated in gypsum produced because the sulphate ions in the sulphuric acid precipitate with calcium ions in the bittern to produce gypsum aggregating approximately $\frac{1}{2}$ to 1% of the total gypsum produced. In other words, the sulphuric acid serves a double function, (1) of controlling the basicity of the solution, and (2) of actually adding weight for weight to the gypsum produced. When defendant operates its bromide department, sulphuric acid is added to the bittern prior to the production of gypsum for the purpose of adjusting the pH of the bittern to permit removal of bromine."

Mr. Bennett: I this morning also stated to your Honor I would like to offer this chart, Plaintiff's Exhibit 16 for identification, in evidence in relation to what it shows in the light of the testimony of the witnesses that have referred to it.

Mr. Rosenberg: I would object to it going in evidence, your Honor. I have no objection to it being a part of the record in order to clarify questions we put to the witness.

The Court: Since the record discloses you made reference to this chart, I think it would be well to have it in.

Mr. Rosenberg: All right. I have no objection. I would like the record to show, however, that we do not concur in the accuracy of that. On the contrary, it is our contention that [1223] that is not a complete depiction of the processes that it purports to depict.

The Court: It is a fair statement to make that it is the theory of the plaintiff's case.

Mr. Rosenberg: Well, not even with that qualification because there is one entire process they have not even purported to show on that, and that is the bromine.

Mr. Bennett: Bromine is not being produced at this particular moment as I understand it, and for that reason we omitted the bromine and I do not think that has any particular bearing on this case except in so far as the matter of sulphuric acid was concerned.

The Court: The only thing I had in mind, we referred to the chart during the examination. So there is no question about it, for that limited purpose, let it be admitted and marked.

(The chart referred to, heretofore marked Plaintiff's Exhibit No. 16 for identification, was thereupon received in evidence.)

Mr. Bennett: In connection with that, may we have an understanding that this chart can be withdrawn at some propitious moment when it won't be wrecked by rain, so we can make, as near as can be, a copy on a smaller, reduced scale.

Mr. Rosenberg: Why not have it photographed?

Mr. Bennett: I do not know what process will lend itself [1224] now. I will furnish a copy to counsel, and if there is any question about the propriety or validity of the copy, we can perhaps straighten it out later.

Mr. Rosenberg: Your Honor, I would like to put Mr. Wallace on again for four questions in surrebuttal. It will take about three minutes.

The Court: Very well. Call him. [1225]

Mr. Rosenberg: Incidentally, I notice I have in my hand, if the Court please, Defendant's Exhibit L, which is marked for identification. It was my understanding this was the laboratory report of that experiment that was run in the plant in making gypsum without the use of sulphuric acid. I thought that that went into evidence. I had intended to offer it in evidence.

The Court: Let it be admitted and marked, if there is any question about it, at all.

(The report referred to was thereupon received in evidence and marked Defendant's Exhibit L.)

DEFENDANT'S EXHIBIT L

Westvaco Chlorine Products Corporation

Process Control Division

Newark, California

October 20, 1947

W. K. Wallace, G. M. Stark, H. L. Bradley, C.
M. Cimino.

To: F. Melhase

From: N. R. Dunbar

Subject: Production of Gypsum from Unacidified Bittern.

The gypsum department was operated during the period 10-10-47 to 10-14-47 with unacidified bittern. This test was made to determine whether satisfactory gypsum crystal sizing could be obtained from alkaline bittern and whether the gypsum filter will operate satisfactorily under such conditions. This method of operation would eliminate the acid addition to raw bittern and the resulting saving would be approximately \$1,000.00 per month in sulfuric acid cost as the only acid necessary would be approximately 10 gallons per day added to the filter bowl slurry to prevent the filter cloth blinding with calcium carbonate.

For this test a small pressure tank was installed from which sulfuric acid was lifted to the gypsum slurry mill hopper. A rotometer was used to measure the flow of acid.

Considerable trouble was experienced with the filter operation and it became necessary to change the cloth after only three days of operation on

unacidified bittern. Under normal operating conditions the average life of a filter cloth is approximately 4 months. At the time this test was made the filter cloth had been in service about 2 months.

The net result of using unacidified bittern was a loss of production due to the time lost in changing the filter cloth and to a lowering of filter capacity. During the 4 days of the test, the total gypsum production averaged 86 tons per day. However, the duration of the test was too short to accurately determine the ultimate capacity of the gypsum department when using unacidified bittern.

/s/ NORMAN R. DUNBAR.

NRD:ro

WILLIAM J. WALLACE,

called as a witness by the defendant in surrebuttal, and having been previously duly sworn testified as follows:

Mr. Rosenberg: Q. Mr. Wallace, referring your attention to this Exhibit L, were you in the plant at Newark on October 10, 1947 to October 14, 1947, at which time this experiment was run for the purpose of determining whether or not you could effectively make gypsum without the use of sulphuric acid? A. I was.

Q. Can you state of your own knowledge whether or not the sulphuric acid free bittern which was run through the gypsum department for the purpose of this test was likewise run through the magnesium department? [1226]

A. It was.

(Testimony of William J. Wallace.)

Q. Can you state whether or not magnesium oxide was produced from the bittern that contained no sulphuric acid?

A. Magnesium oxide was produced.

Q. Can you state whether or not the quality of the magnesium oxide was in anywise affected by the absence of sulphuric acid?

Mr. Bennett: I do not know that this witness is qualified, I would not consider him qualified to that extent, and I object to it on that basis.

Mr. Rosenberg: Q. Let me ask you this: Was the magnesium oxide that was produced from the bittern in which no sulphuric acid had been run, sold and used in the same way as the other magnesium oxide produced from bittern containing sulphuric acid? A. It was.

Q. And did you have any objections made to the quality of it? A. None whatever.

Mr. Rosenberg: That is all.

Cross Examination

Mr. Bennett: Q. Do you know to what particular customers this particular magnesium that was produced without the use of sulphuric acid was delivered?

A. Part of the magnesia produced at that time went to Weyerhaeuser, in Seattle.

Q. During this short period of time? [1227]

A. In that short period of time, during those four days, the magnesia produced went to our normal customers, regular customers. We had Peri-

(Testimony of William J. Wallace.)

glase going to Lavino, and we had Lightburn magnesia going north to Weyerhaeuser.

Q. This magnesia that was produced during that time went into your regular stock, did it not?

A. Our regular stock is ground and sacked and shipped out almost continuously as it is produced.

Q. After it goes through the final processes of treatment to make the magnesium oxide it is stored in large containers, isn't it?

A. Well, I would say that the Lightburn production is stored in a tank that holds about 40 tons, and a day's production is 30 tons. So you do not have very large storage for the Lightburn product.

Q. You did not run, yourself, any tests to determine the relative quantity and the relative precipitations, and so forth, of magnesium oxide during the time you were not actually employing the sulphuric acid, did you?

A. Our laboratory ran tests on shift samples. Every eight hours they took a sample.

Q. This report dated October 20, and which is now Defendant's Exhibit L, says nothing at all about the effect on magnesium oxide, whether or not sulphuric acid is used. You are aware of that, aren't you? [1228]

A. Yes, sir.

Mr. Bennett: No further questions.

Mr. Rosenberg: That is all. The defendant rests.
(Defendant rests.)

Mr. Bennett: The plaintiff rests, your Honor.
(Plaintiff rests.)

Mr. Bennett: There is one matter your Honor has spoken of during the trial, and both counsel have spoken of, and that is the matter of correcting errors that may appear in the transcript.

The Court: I do not think either one of you will have any difficulty with the reporter in that matter.

Mr. Bennett: Such system as we arrange mutually will be satisfactory to the Court and we can communicate with the reporter or your secretary as to the corrections in the original?

Mr. Rosenberg: I think Mr. Bennett and I can get together and file something in the nature of a stipulation on the corrections so we do not have to change the actual transcript.

The Court: That is all right. The case is submitted 10, 10 and 5. That will bring us to what date?

The Clerk: January 28th for submission.

The Court: January 28th for submission, gentlemen.

Mr. Bennett: It may be, as your Honor suggested, perhaps your Honor would want oral argument after the briefs are in. If your Honor desires, we will hear from your Honor in that [1229] particular.

The Court: If I call you in for argument it will be because I cannot satisfy my mind in relation to the authorities and the briefs that you submit. Ten, 10 and 5, gentlemen. That will bring us to January 28th. Keep in touch with the clerk after the briefs are filed. Give me an opportunity

to check your briefs, and then if I feel that I need some argument on anything, I will frankly call you back and ask you to clear up any question that may be in my mind.

Mr. Rosenberg: Thank you, your Honor. I think Mr. Bennett and I both feel that we have had our full day in Court. [1230]

Friday, February 27, 1948

OPENING ARGUMENT ON BEHALF OF PLAINTIFF

Mr. Bennett: Your Honor, I am sure both sides appreciate this opportunity to present to the Court an oral argument in this case. It was a rather lengthy trial. The case was quite novel in its issues. Briefs have been filed by both parties, but in an effort to keep lengthy written arguments to a minimum consistent with the issues there are matters that perhaps lend themselves to an oral presentation.

The Court: I quite agree with you. I suppose if I had given the briefs submitted here the attention that they deserve I would do nothing for thirty days. But I attempted to check those cases. The truth is that both sides can simplify this problem by indicating clearly what answers the Court may give the record here.

Mr. Bennett: Yes, your Honor. I think that is in order, and I think perhaps with this time your Honor has given us we may develop matters which, due to the mass of testimony, otherwise might be somewhat obscure.

This is a declaratory relief action in which both parties seek a declaration of their rights and obligations under three of the paragraphs of the contract for the sale of gypsum by the defendant to the plaintiff, which was executed on January 29, 1937, and which contract has been in force since that time and performance by both sides.

Commencing in 1944, some seven years after the contract was [2] executed, a dispute arose between the parties. This dispute primarily centered around the construction and application to be given to paragraph 6 of the contract, the so-called price protection clause. Later a dispute also arose as to other paragraphs, paragraph 5 of the complaint, which provides for the deductions permissible to the plaintiff in case the gypsum falls below a certain standard and allowed tolerance, and paragraph 3 of the contract, which provides for an option of the plaintiff to decline to take over a specified amount of gypsum during any calendar month and during the calendar year.

The first controversy, and the primary controversy, so far as the major issues involved, concerns paragraph 6, the price protection clause. Your Honor will recall that the parties agreed on the price asked by the defendant's predecessor, namely, \$2.80 per ton, and paragraph 6 was inserted to protect, and solely for the purpose of providing some measure of protection to the seller, the defendant, in case the price increases. The dispute concerning that particular paragraph, stated in its utmost simplicity, is whether the defendant is

entitled to increase the contract price based upon the actual expenses and costs of producing this by-product gypsum, the cost that it would entail because of the production of gypsum, the costs which would not be incurred if no gypsum was produced, or whether it may also include any raises that it asserts in its system of [3] accounting for its so-called overhead of doing business, including a portion of its western division headquarters expense and its New York office, costs that the evidence in this case, by written admissions of the defendant in the interrogatories, answers to the interrogatories, admit would go on and be a costly burden to the defendant company, whether or not gypsum was produced, and which, to be allocated, requires, according to the admission of the defendant's witnesses, an arbitrary allocation, presenting, as the evidence has shown your Honor, not only difficulties but impossibilities in determining whether the purported allocation has any direct application to the production of gypsum, and if so, how much. It is the plaintiff's position, and it has been the plaintiff's position consistently from the beginning, that under the contract, and according to its meaning as appears on the face of the contract, the actual increase in the cost of manufacture of gypsum, which is provided for as a base for any price increase during the comparative period of twelve months, means the actual, determinable costs, and does not mean a speculative or conjectural or arbitrary allocation of the general cost of doing business of the defendant's plant or western headquarters and New York office, costs which are in many

instances unable to be shown and have not been shown by the evidence to have any relation to the production of gypsum, and which cannot be determined and which cannot be determined, and which do not constitute actual [4] cost of the production of gypsum.

I think, your Honor, in view of the issues of the case, particularly as pertains to paragraph 6, this price protection clause, the court should consider and I propose in a short period of time to review the factual background because, if it please the court, the defendant in this case has asserted that the contract is uncertain, that this term "cost of production" as a basis for price increase is so uncertain as to render invalid the whole contract. The defendant therefore has charged an uncertainty. With that charge the court is not only permitted but should, of course, inquire into all the facts and circumstances leading up to the execution of the contract, and what I consider most important, your Honor, the talk and the actions of the parties in the years following the execution of the contract up to the time the dispute first arose, because it is our position that under the evidence in this case, and under the indisputable facts in writing, as well as the credible oral testimony, the parties, including the defendant and its predecessor, understood and intended that the price protection clause, paragraph 6, did not contemplate or provide for any allocation of so-called overhead or indirect charges of the defendant's plant or business as a part of the actual advance in the

cost of manufacture of gypsum. Of course, in that connection, your Honor, I will later refer to the expert evidence in this case and show to your Honor that [5] the testimony of the plaintiff's experts is the evidence that has actual probative force and is credible, and that the testimony of the defendant's purported experts absolutely ignore the provisions and purposes of this contract, and for that reason alone their testimony must be disregarded and the testimony of the defendant's experts accepted. But I repeat again, for three separate reasons, the plaintiff's contentions and position with reference to the proper interpretation to be given to paragraph 6 should be accepted: First, the proper interpretation of the contract, itself, and the language of the contract; second, prior and contemporaneous construction given it by the declarations and actions and conduct of the parties; and third, upon the evidence that has been offered to your Honor from the experts. In connection with the last separate and independent reason that I will develop in more detail at a later juncture of this argument, I want to bear in mind, your Honor, at the outset, that this trial, as in his deposition, Mr. Barrows in talking about the discussions he had with Mr. Colton leading up to the execution of this contract and the language of paragraph 6, never once said that he intended or understood that this clause should cover overhead or indirect expenses. The most that his testimony can be said to convey, accepted in its most favorable light and ignoring all the conflicts that appear in

his testimony before the court and that given in his deposition, and as contradicted [6] by Mr. Colton, there was not a word of it that he ever told Mr. Colton, that he ever expected or intended this contract to provide for the allocation of overhead or indirect expenses. All he was concerned with was that he did not want to limit himself (so he said before your Honor at this trial), to the three items, and only three items, which he proposed as the basis for any price increase, namely, an advance in the cost of labor, fuel and supplies. As a matter of fact, if your Honor please, as plaintiffs have construed this contract, they at all times have been willing to allow many costs in addition to those three Mr. Barrows first proposed. We have allowed repairs. We have allowed all costs of supplies and materials that have to do with the manufacture of the gypsum. We have been willing to allow depreciation, taxes and insurance upon the physical plants or that part of the plant that is used for the processing of gypsum—in fact, all the costs and expenses that defendant has, which are incurred and necessary to the production of gypsum, and which would not exist if the gypsum was not produced. In other words, we are not only willing to pay the actual manufacturing cost, but the depreciation of the physical plant and the direct shipping expense, which was not originally proposed by Mr. Barrows, and the taxes and insurance, providing taxes and insurance and depreciation are based upon a proper method of allocation. The defendant admits here that they roughly allocate

them upon their [7] relation to value. In a contract of this kind, particularly where the plaintiff has consistently attempted to live up specifically to the terms of the contract, something roughly approximated is not the proper method. We feel, and the evidence clearly shows, that it is entirely possible to charge a proper rate of depreciation, not on the basis of the method the defendant has proposed, the straight line method, but in relation to the tonnage produced; and as to taxes and insurance, it is a very simple matter, or should be if the defendant is willing to comply with the contract, to determine the cost of insurance and taxes upon the physical part of the plant used for processing this by-product gypsum. We will pay it. Consistently that has been our position.

But I want to preliminarily point this out to your Honor: Mr. Barrows testified in his deposition and even on the witness stand, that he said, "I propose, instead of specifying the particular items of cost, that we leave it to the accountants." That was his testimony before your Honor, and was his testimony in the deposition.

What is the position of the plaintiff with relation to that? When this dispute first arose in 1944, seven years after the contract was adopted, the plaintiff said, "All right, we want to go ahead with this contract. We made plans upon promises that you made in this contract covering a period of years. We want to comply with them. We want to live up to [8] it. You are wrong now in taking a different stand than you have heretofore taken.

But to reconcile this contract, we will do as Mr. Barrows first suggested, and finally suggested when the term, according to Barrows' testimony, was agreed upon in the contract:

“Leave it to the accountants. You appoint your expert, we will appoint ours, and the two will appoint an impartial expert and let him decide what costs shall be included in the actual advance of the cost of the manufacture of gypsum.”

Now, we were entitled to ask that because Mr. Barrows has told your Honor in his testimony here that that is what was the meeting of minds. But now the defendant would not agree to that. I think that that point is significant, your Honor, not only as to show the question of good faith, to show what the parties had in mind, but also to check the force and effect of this purported expert testimony that the defendants have produced before your Honor. If, according to good accounting principles and practices the actual advance in the cost of manufacture of this by-product gypsum included this arbitrary allocation, and the witnesses for the defendant finally admitted that whether you do it on a labor basis, which the defendant's witness Farquhar said was not the proper basis for allocation, or any other basis, it would involve an arbitrary allocation which would not determine actually the [9] relation of any cost. But they would not do it, and they have consistently refused to do that, your Honor, and the only reason obviously for their refusal is that they

know that any qualified, impartial accountant would rule against them, and would rule in favor of the position the plaintiff has taken from the beginning.

But let us go back for a moment to the genesis of this transaction. They started a plant down in Newark. Mr. Barrows was president of the defendant's predecessor. This plant was started prior to 1931. Two years prior to that time they had a pilot set up to explore the matter of manufacturing bromine and magnesium compound from the bittern water that they were obtaining from the salt company. Mr. Barrows at the trial here attempted to convey the thought to the court that this plant was built really to produce two main products, magnesium and gypsum. Of course, this is disputed **by the written statement of the executive vice president of the defendant's corporation**, who in 1931 wrote this article which your Honor had before you as an exhibit, showing the pictures of the plant down there and describing the purpose and processes, and the article makes it plain that the purpose of that plant was to produce bromine and magnesium and, moreover, he says as early as 1931 it actually started production. Mr. Seaton said:

“Accordingly, after extensive laboratory investigation and some two years' pilot operation, a small plant [10] for recovery of these values in other forms is now in production and a large plant is being engineered.”

The forms he was talking about were the magnesium products. No reference made at all to gypsum in that whole article except one little sentence, which reads as follows:

“The by-product gypsum from the process through operation of favorable location factors, is marketable at a profit instead of being a valueless waste.”

In 1936 Mr. Barrows approached Mr. Colton. By the way, that favorable market factor, it has been admitted by Mr. Barrows, consisted of the plaintiff's plant being located over there in Redwood City, just a short distance across the neck of the bay from the Newark plant of the defendant. Mr. Barrows approached Mr. Colton and made a proposition to him, and it provided several things. It provided that the California Chemical Company, the defendant's predecessor, would buy oyster shells from the Pacific, the plaintiff, and would sell the gypsum that they produced at the plant, except 3000 tons, which they would reserve, and it also provided that they would sell to the defendant quicklime and hydrated lime at a certain stipulated contract price. The contract price for gypsum then proposed by Mr. Barrows was \$2.60 a ton, 20 cents a ton less than the contract finally provided. In that first proposition Mr. Barrows said, “The contract would contain certain price protection clauses to guard against increases [11] of labor, fuel and supplies”—only three of a number of actual or direct costs of producing gypsum, which the plaintiff under this contract has at all times been willing to allow. Again, after some negotiations back and forth, Mr. Barrows again came along with a proposal to Mr. Colton in his letter of September 18, 1936, including a rather

rough draft of an outline for a contract for the sale of lime and gypsum by California Chemical Company, the defendant's predecessor, to the plaintiff, and that proposal stated that the price would be \$2.88 a ton, which price was based upon the defendant's direct cost of manufacture. In other words, the contract price in this case, in this final contract, was the sum of \$2.88, and according to the written declaration, Mr. Barrows in his admissions before your Honor, that price of \$2.88 was based upon the direct cost. They were not thinking at that time of figuring as a part of the cost of gypsum this so-called overhead of doing business. That proposal of September suggested that there should be a price protection clause for both lime and gypsum, based upon the average direct cost and protect against price advances, labor, transportation, fuel or supplies—again a few and a limited number of actual or direct costs, which, as I say, plaintiff has been willing to allow.

There is some dispute in the testimony. Mr. Colton says there was no discussion with Barrows, no contention by Barrows about the meaning of the words "cost of production" or limiting [12] the cost of production as a basis for any price increase on allocated or other costs. He said the only discussion, according to his recollection, had to do with specifications in this draft. He said the matter at that time then was turned over to counsel for both parties and counsel finally got together and drew the agreement, which was finally signed on the 29th of January, 1937, and paragraph 6 in that contract provides:

“In the event that California’s cost of production of gypsum for any twelve months’ period during the term hereof shall increase 5 percent above its average cost of production of gypsum for the preceding twelve months’ period, then and in that event California shall have the right, upon giving sixty days’ written notice to Pacific, to increase the price payable hereunder for gypsum thereafter delivered hereunder in an amount not to exceed the actual advance in California’s cost of manufacture; provided that in no event **may** more than one such increase be made in any one calendar year.”

Then there is the further language, which is significant, your Honor:

“California shall keep books of account and records showing the defendant’s production cost of gypsum, and such books of account relating to the cost of the production of gypsum shall be open to inspection by Pacific at [13] all reasonable times in order to enable Pacific to confirm the correctness of any advance in price permissible under this paragraph.”

Now, there is another provision, if your Honor please, that I wish to call to your Honor’s attention, and it has been ignored entirely by the defendant. In fact, it has been utterly contradicted and disputed by the whole theory of their case, and that is the opening paragraph of the contract:

“Whereas California contemplates the erection of a plant located at canal head, Newark,

California, primarily designed to produce magnesium oxide in its various forms, which plant will produce as a by-product substantial quantities of gypsum.”

That particular paragraph must be considered and should be considered, if your Honor please, in connection with paragraph 6. It shows, I submit, on the face of the contract, a declaration which the parties cannot dispute either, as to the question that gypsum is a by-product, and they labored before your Honor with their witnesses and counsel's contention that gypsum is not a by-product, that it is in fact a main product. But here is Dr. Seaton saying it was a by-product, and the contract itself says it was a by-product. The character of gypsum as a by-product cannot, I submit, be disputed. The contract precludes them on that. But it has the further significance of showing in relation to paragraph 6 that it was not intended by [14] this contract that the overhead cost of running the plant should be part of the cost of gypsum. Otherwise, what is the purpose of this sort of language? It says that the plant is mainly or primarily designed to produce magnesium oxide, and that could only lead the plaintiff to believe and understand that if there is to be a construction that all of these overhead costs of doing business, the bookkeeping, and the plant guards, and all that sort of thing, that has to be borne by the primary product, and that gypsum, the by-product, so far as determining its cost, should be limited to the costs which are actually required in the produc-

tion of that by-product. That is in keeping with common sense, and it is spelled out in specific language in the very introduction of this contract.

The Court: Gypsum in large quantities.

Mr. Bennett: Yes. It says in the first paragraph of the contract, "California contemplates the erection of a plant located on canal head, Newark, California, primarily designed to produce magnesium oxide in its various forms, which plant will produce as a by-product substantial quantities of gypsum"—just as a person opening up a sawmill, reverting to that illustration, would produce substantial quantities of sawdust if we were dealing with a contract having to do with the sale of sawdust. But the point is so far as that particular paragraph of the contract is concerned, and particularly in relation to the question of the interpretation of paragraph [15] 6, it further shows that the overhead, the cost of running the plant down there was contemplated and intended by the parties to be borne by the primary or the main product, the purpose for which the plant was built.

I pause at this junction, if your Honor please, to go away from the contract and back to Mr. Barrows' contention, because, as I told your Honor, these declarations and statements of the parties prior to the execution of the contract are important as a separate and distinct element of evidence and proposition to support the plaintiff's construction of this contract, particularly in view of the contention of the defendants that the term "actual advance in cost of manufacture" is uncertain or

ambiguous. I pointed out to your Honor that in the two written proposals that we have in evidence, and the only writings that we have in evidence prior to the execution of the contract, the one in June, 1936 and the one in September, 1936, indicate that Mr. Barrows at that time had no idea of charging overhead or allocating, arbitrarily or otherwise, overhead to this cost of gypsum. Admittedly, the price of \$2.80 was based upon the direct cost, the actual cost, which does not include overhead or indirect items, and his two proposals in writing that he has made to the plaintiff both say, "All we are interested in is protection against the cost of labor, fuel and supplies." He has even limited himself to a few—three—of the several items of actual or direct loss which [16] the plaintiff has at all times been willing to allow. Now, when he came before your Honor he attempted to make some explanation here of some discussions or objections that he had to these proposals. He says the reason for his objection was because of limiting the price increase to labor, fuel and supplies because the plaintiff would not agree to a cancellation clause in favor of the defendant, in favor of Mr. Barrows' company.

Now, Mr. Barrows was cross-examined, your Honor, with reference to his deposition. The deposition was taken some months before. He was a sick man when he testified before your Honor; he may have been ill at the time of his deposition, but I was not apprised that he was in any sense under his disability, and perhaps his disability at

the trial is responsible for his difference in testimony. The purpose of that deposition was, of course, to pin Barrows down to everything that was said by him or Colton leading up to the execution of the contract. In his deposition he did not say a word about discussing with Colton this cancellation clause. In his deposition all that he said was that Colton wanted a provision in the contract that the defendant, or Mr. Barrows' company, would keep books satisfactory to Pacific, and he objected to that because he did not know what would be satisfactory to Pacific, and so he said. "Let's leave it to the accountants. Let's put in 'cost of production' and leave it to [17] the accountants.' " It will only take me a minute to read some of Mr. Barrows' testimony on his deposition.

Mr. Rosenberg: Where are you reading from?

Mr. Bennett: I am reading from page 846 of the transcript of the trial. I am not reading from his deposition, but I am reading from the transcript of the trial as to what he said on his deposition. These questions were asked:

"Q. Well, at that time"—you were referring back to June 5th and September 18th, 1936—"you were proposing that any increase in price by reason of any increase in cost should be limited to those increases in direct costs, such as labor, supplies and/or materials and fuel? Wasn't that so?

A. I wouldn't think so, Gene. It is a starting point.

Q. Well, did you have—

A. And I know we had a lot of talks on that afterward.

Q. Well, did you have any—withdraw that. What talks did you have afterward, and with whom, concerning that?

A. Mr. Colton and myself talked on numerous occasions.

Q. You mean after—

A. After this preliminary draft.

Q. Of September 18th? A. Yes.

Q. And what was said concerning that?

A. I couldn't answer that. [18]

Q. You have no recollection?

A. No. I know that we talked on a lot of points, because this final contract, I believe, would show that we didn't follow this.

Q. You don't recall anything specifically said by you—

A. I can remember discussing the cost matter, I can remember discussing this amount clause, how much they were to get, you know; I can remember discussing in a general way chemical specifications to this extent: He said, 'Well, what are your chemical specifications?' I said, 'I don't know a darn thing about chemicals,' I said, 'You pick a man who attends to those things from your organization and I will designate a man from the California organization and let them determine what your chemical specifications should be.' We did put in quite a lot of work in arriving at that point, but what the words were I couldn't tell.

Q. But you don't have any recollection of any specific discussions with Mr. Colton or anyone else connected with or representing the Pacific Port-

land Cement Company with reference to the nature or type of costs that would be such as to entitle you to an increase in price?

A. Well, what would entitle us to an increase was what we would finally decide upon, and we did talk that thing out and it took quite a long time, and that is what resulted [19] in their finally changing the thing to just cost of production. My thought was to 'leave it to the accountants, what cost of production is.'

Q. Do you recall anything specifically that Mr. Colton said with reference to that? A. No.

Q. Do you recall anything specifically that you said, other than 'leave it to the accountants, what the cost of production is'?

A. That is my final remembrance."

And then counsel asked me to read other parts of the deposition and I did read what he asked, and I now quote from the bottom of page 849 of the transcript:

"Mr. Bennett: Q. Will you state what that bone of contention was?

A. Well, it is pretty hard to remember, but I do recall this: In one case, in one of the drafts they submitted—well, I don't even know what you have in your file. You may have that. If I could see it, I could tell better, but we got to discussing what would be costs. I did not want to limit it to the first items that we had outlined, because we got to figuring that we were going to have to put up the plant to make this gypsum. At first we thought we could put in a drier and then later it transpired

we would have to put up a plant and put in equipment, and [20] Colton put in a paragraph that the production costs— we were to have the right to decrease—keep records of the costs of production in form satisfactory to Pacific, and I said, ‘No, we can’t do that, because I don’t know what “form satisfactory to Pacific” might mean. It might mean anything.’ And then I suggested, I countered with a ‘form in keeping with good accounting practice—accepted practice, and I left that note with Williams, and I think—again it is awfully hard to remember these things ten years ago, but I think they said, ‘Well, we will just put in “cost of production” and that will cover it. It is too involved to try to outline what every cost of production is.’ This is my recollection.”

There was nothing said by Barrows in his deposition, although he was repeatedly questioned as to what conversations he had with Colton, about any cancelation clause. But what is more important, and what I think is decisive and determinative in this case, striving as poor Mr. Barrows did on this witness stand with a different story than he told in his deposition, he did not say by word or inference that it was intended by him or sought by him or intended or sought by Colton that this term “actual advance in cost of manufacture” as the basis for a price increase should include overhead or an allocation of indirect and other charges. I submit, if your Honor please, in view of the fact that the evidence so clearly shows in [21] indisputable form that all that he wanted in the begin-

ning was just three of the direct costs, fuel, labor and supplies, and that there isn't any credible evidence to show that at any time there was any meeting of minds or an intention even to assert that there should be included an allocation of overhead and indirect items, that that shows, aside from the language of the contract, and certainly it supports the language of the contract as we contend it should be construed, that the parties considered only and were only seeking and only intended by this final contract which was executed, providing a so-called price protection clause, increases that occurred in the actual cost of the production of gypsum, not any arbitrary loading of overhead and indirect items of the plant down there that was primarily designed, as the contract admits, for the production of magnesium oxide.

I come to the next step of the chronology, your Honor, that I think is important. How did the parties treat this contract for a number of years? The contract price of \$2.80 a ton was paid until 1941 and then for the first time the defendant asserted an 18 cent price raise. Prices had gone up, as your Honor knows, at the beginning of the war period. Mr. Colton called down at the plant down there. He testified no one at the plant or otherwise had told him they were basing an increase on overhead or indirect items. But we have again a writing that can not be disputed. Here is this letter of October 2, 1941. It was sent to Pacific by Westvaco. It says,

“Gentlemen:

“In accordance with request of yourself and J. H. Colton, while in conference with Mr. Wallace yesterday, we have analyzed gypsum production costs for the years ending June 1940 and June 1941. We are attaching hereto a recapitulation of labor, material and power costs, which accounts for 15 cents per ton of the 18 cents per ton increase of which you have been previously notified, and which increase is effective October 5, 1941.

“If you desire further information in re the attached statement, or in connection with our basis of determining increase in costs, please call on the writer.”

And attached to that was the outline entitled “Gypsum Manufacturing, July 1939—June 1941,” in which they show a two [23] cent increase in labor, a ten cent increase in materials, and a three cent increase in power. Clearly that writing, if your Honor please, shows that at that time, years after the contract had been executed and when the first price raise was sought to be made, they did not assert that they were entitled to make a price raise on allocated items of overhead. But they say here that 15 cents of the 18 cents accounts for only three items of direct cost, and assuming that the other three cents involved one or more of the other items of direct cost, which the plaintiff at all times has been willing to recognize, we paid that sum of money and it was only after O.P.A. was in effect, and after, in 1944, when they sought the second price raise, that we were told they

based this first price raise on indirect costs. Then they contended for the first time that instead of being 15 cents out of the 18 for labor, fuel and material, that there was only a 9 cent raise in direct costs, something entirely contradictory and inconsistent with the written notice and the declarations that they made at the time that the first price raise was made.

If your Honor please, I think that that fact, contemporaneous construction, which is always of the utmost importance when the question of the interpretation of any clause of a contract is asserted, should alone persuade your Honor or any judge to hold against the contentions of the defendant in this case.

Obviously, my time is running to a close and I shall not [24] be able to develop this argument except to hit the high spots, if your Honor please.

We discussed this burden of proof proposition. The matter is briefed in our briefs. The contention by counsel, simply stated, is that merely because we brought this suit we have the burden of proving that their asserted price increases are not proper. Obviously that is wrong. We have cited a number of cases to your Honor that the mere fact that in a declaratory relief suit, plaintiff brings the action, does not make him carry the burden of proof. It is the person who has the affirmative of the issue who has the burden of proof, and the defendant in this case has the burden of proof and the affirmative of the issue on the matter of whether or not there is an increase

of price. I will not take any more time in this argument, your Honor, to mention that because the matter is covered in the brief and I am satisfied after reading those authorities, and even considering one or two other authorities that indicate to the contrary, your Honor will find not only by the balance of considered judicial opinion, but with the common rule of reason, common sense, the defendant has the burden of proof.

If your Honor please, on the question of the contract and its application we have cited cases on both sides with reference to the meaning of the term, "Cost of Production," or "Actual Cost of Production." In all cases cited by the defendant [25] it did not involve a situation of this kind where we had a by-product or where there was a matter of allocation, except in one case, the Ford Motor Car case, which I will not discuss here in argument other than to say that in that case the court held that by allocation you do not determine the actual costs and the only reason they allowed allocation there was because Ford had consistently followed an allocation purpose, and it was a suit by a patent owner for infringement, and he was claiming as a basis for his infringement not only a saving of the actual cost but the overhead as well. The case is entirely distinguishable and the court in that case states you do not determine actual cost by any process of allocation.

On this matter of uncertainty, I want to say just one word about that. Though laboring for twenty pages in his brief, counsel has been unable to cite

any case in which the courts have held invalid a contract because of the uncertainty of the words "cost of production." The courts have said in many of the cases cited that this term requires other evidence to explain it, but in each instance the court has applied that evidence in keeping with what it found was the intention of the parties and upheld the contract. The only instance where the court held invalidity was in the case of a criminal statute where, of course, the rule is entirely different.

If your Honor please, I want to say one word—and I feel I am doing a wholly inadequate job. I must close. I think I [26] started 15 or 20 minutes past ten, and I want to allow counsel an equal time with your Honor's indulgence—about the testimony of these experts.

Despite the fact that the contract says that gypsum is a by-product, all of the defendant's witnesses in saying that they would allocate overhead, and so forth, admit, if your Honor please, that that would involve something arbitrary. It might be all right if only the interest of the manufacturer was concerned. And they were dealing with that situation. They were not dealing with a case where the contract required something actual and definite. And each of them admitted that they saw no difference or distinction between accounting for a by-product and accounting for a main and a co-product. Every one of them took that position flatly. There was an attempt to show, "Oh, the books, the authorities report that." They do not.

Your Honor will recall that I produced this handbooks here when the witness Maxwell said, "Yes, that is a very authoritative book and it is a compendium of all the other books," and I showed in that case there is a definite distinction and difference between by-product accounting and accounting for a co-product and a major product, and I showed an instance where in the coke industry the main product was charged with the overhead and the by-product was not. I showed that in the majority of instances they did not figure only the cost of a by-product but credited sales of the by-product against the cost of manufacture [27] of the main product.

And then he said, "I do not like that. I don't think the book should draw any distinction. For that reason I don't like the book."

We produced four outstanding witnesses, if your Honor please, men of the highest standing and repute in the accounting profession. All of them were unequivocal in saying that in a situation dealing with a by-product you should charge against it only the cost of its production, the things that would be involved in producing it. You should not include things that would go on if the by-product was not to be produced. And I think, if your Honor please, that Dean Jackson summed this thing up in a sort of homely commonsense fashion that should appeal to the Court. He said, "Most business men would not include as a charge against that by-produce that portion of the general overhead which would go on just the same, whether the

by-product was produced or not. In other words, the product must stand on its own feet as to whether or not it will pay the organization to produce that product from the time it is split off from the main product, and if it will not, any sensible business man would not proceed to produce it."

And in this instance, if your Honor please, the defendant does not have to produce gypsum according to its contentions. It can produce other products out of these sulphates that otherwise would be a waste, and which are necessary to remove from [28] the bittern in order to produce the main product, magnesium oxide. It is told us repeatedly, "If you don't pay us our demands, everything we demand, we are going to stop it and we will produce other products and the contract will be at an end."

Why, they have something better than an escape clause in this contract, as far as that is concerned, than that possessed by the plaintiff. According to their contentions and statements, they can stop manufacturing this gypsum at any time and use the sulphates for some other purpose. Dean Jackson said it is just a matter of commonsense, and I think that is the rationale of the rule that was relied upon by each of the plaintiff's witnesses in this case, and the testimony of the defendant's witnesses on this accounting point can not be accepted because they ignore the provisions of this contract, which are based on the manifest purpose and the obvious intention of the parties as revealed

by their declarations and by their conduct, both before and after the contract was executed.

I have not argued, if your Honor please, this case in any detail that I would like, particularly pertaining to the authorities applicable. Perhaps the best way to consider those authorities is in the brief, but I submit, if your Honor please, it is shown by our briefs that the authorities are entirely in support of the plaintiff here, and the authorities that have been cited against us are all distinguishable.

There is one point on this sulphuric acid matter which I [29] wish to point out to your Honor and then I will close and I will rest the argument concerning paragraphs 5 and 3 of the contract upon the argument we have submitted in the briefs.

The Court: Briefly stated, with respect to paragraphs 3 and 5, what am I to determine in relation to paragraph 6?

Mr. Bennett: Paragraphs 3 and 5 have no relation to paragraph 6. They are separate issues. Under paragraph 5 your Honor is to decide as to whether we are entitled to deduct for fractions. For example, it provides, as your Honor knows, that if it falls below a certain percentage we are entitled to deduct 10 cents per ton. Consistently the plaintiff has deducted for fractions. For example, if it falls 2.9 per cent below the allowed tolerance, we deduct 29 cents, and that seems to be an exact and fair transaction. On the other hand, the defendant contends that we can only deduct 20 cents, that it has to be a full per cent before any deduction can be made.

There is another issue under paragraph 5 as to whether the samples should be by carload lots or by weekly production; they would screen something like 20 carloads. Historically and through the years we have always had carload samples until 1946, and we say that that practice should continue because the carload is the unit of measurement so far as deliveries are concerned, and the defendant should not be permitted now to change it and give us a sample only of a whole week's production or approximately 20 cars simply so that it may average out [30] and gain perhaps by that averaging process. The same practice that has been followed for years should prevail now. It is consistent with the contract and the only fair and accurate way in which to determine this question of quality.

The other issue as to paragraph 3, if your Honor please, simply is a question of law to be determined from the contract language. We say that we have two separate rights: one, to refuse in excess of 2,000 tons per month and also to refuse independently of that more than 20,000 tons per year. The contract is perfectly plain on that, and the defendant's contention is that we must elect one or the other, that we can not have both. There is nothing in the contract to support counsel's contention in that respect, and it is a simple matter that I submit your Honor will very easily decide from the plain language of the contract.

I want to say one word about sulphuric acid because that is an important thing. Your Honor recalls under the evidence up until 1946 there was never any charge against gypsum for sulphuric acid, and then suddenly they switch this charge of sulphuric acid because they say, "Well, we stopped producing bromine and sulphuric acid is desirable or necessary for the filtering out of the gypsum; so we charge it now all to gypsum." That charge is not right. It is not an overhead or an indirect charge in the strict sense. Had they in the beginning made the charge of sulphuric acid to gypsum, and if sulphuric acid was [31] used and necessary for gypsum production, then there might be a different situation, but I say they can not go on for ten years making no charge for sulphuric acid and now at a later date, when they are trying to build up, pad and load their costs as they did with indirect shipping through a value basis when all during the preceding years it was on a tonnage basis, they can not suddenly, in the comparatively later period of the contract, make a charge for sulphuric acid which at no time had been charged against gypsum. As our witness Kleckner testified, this sulphuric acid is necessary and desirable for the manufacture of the main product, magnesium oxide. That is what it is used for and that is what it serves; that it has no function particularly so far as the manufacturing of gypsum is concerned, and as Dr. Seaton said in his article. this thing goes through the whole process. Obviously, there is no proper basis for a charge of sulphuric acid sur-

denly to arise in 1946. It is neither a proper charge against the gypsum and, secondly, they can't entirely eliminate it in one year and add it in the next simply because they stopped the production of bromine. Think of what would happen. One year they would produce bromine and charge all the sulphuric acid to bromine; next year they would charge all that to gypsum and switch back to producing no bromine, and then that builds it up and every other year they could add, in a pyramiding and compounding fashion, a charge for sulphuric acid which perhaps in ten years might amount to \$2 a [32] ton. It would produce a perfectly absurd and ridiculous result. For several reasons it is improper, if the Court please, to allow any charge against gypsum of this sulphuric acid.

I am sorry that I have gone so far, but I felt I should spend considerable time with some of these facts, if Your Honor please, that I think certainly point the way to give an answer to the issues which are presented before Your Honor.

The Court: We will take a recess.

(Recess.)

ARGUMENT ON BEHALF OF THE DEFENDANT

Mr. Rosenberg: If Your Honor please, I am not going to attempt to re-argue everything that is contained in the briefs. I guess the briefs are longer than the Court anticipated, and I realized it would cast considerable burden upon the Court, but as much as I tried, I just could not confine it to a shorter brief than was eventually filed. So I am

going to devote myself primarily to a response to some of the things that counsel stated, and first I would like to direct the Court's attention to this question of the statement that was submitted by the defendant to the plaintiff in 1941 showing 15 cents of the 18-cent increase that went into effect at that time. Counsel referred to that and would have the Court infer from the circumstances that at the time the 18-cent increase was made effective the defendant rendered a statement which was based only upon direct costs, and it was not until 1944 that the defendant took [33] the position that all costs which even plaintiff's so-called experts admitted are properly includable in determining the cost of production of a manufactured product should be included. Now, the facts with reference to that statement are as follows: Your Honor will recall that a notice was sent from the defendant to the plaintiff that pursuant to paragraph 6 of the contract, defendant's cost of production in the period from July 1, 1940, to June 30, 1941, having increased 18 cents over the preceding 12 months' period, therefore the price would be escalated pursuant to paragraph 6 of the contract from \$2.80 to \$2.98 a ton. Counsel neglected to mention to you what the testimony shows, and that is that following the receipt of this notice there was a conference at the office of the defendant between the accountant for the plaintiff and the accountant for the defendant, the purpose of the conference being to enable the plaintiff to review the defendant's figures and ascertain the propriety of that 18-cent increase. The

evidence is uncontradicted that they spent several hours together and no question was raised at that time, so far as the evidence shows, by the plaintiff as to the propriety of that 18-cent increase. The evidence is uncontradicted that at that time Mr. Camden, the auditor for the plaintiff, requested that certain information be furnished by the defendant to the plaintiff in the form of a statement, and it was pursuant to that request that the statement to which counsel referred was sent, and it showed a [34] 15-cent increase in labor, materials and fuel. Obviously that statement did not purport and was not intended to substantiate the entire increase of 18 cents. It was not rendered for that purpose, it did not purport to be for that purpose, and the letter of transmittal expressly said, "This is rendered in accordance with your request and if you want any further information, please do not hesitate to call upon us." The inference is irresistible that either the plaintiff knew what the balance of the 18-cent increase was or at least there is no evidence in the record that there was any misrepresentation or any withholding of information or that there was ever any request made by the plaintiff of the defendant for any further information. The first time that such a request was made was in January of 1944, when Mr. Flick first entered the picture, and then he for the first time requested a statement showing the full 18-cent increase, and it was pursuant to that request that the second statement, which is attached to Defendant's Exhibit A, was furnished, showing the full derivation of the

18-cent increase. Counsel would have a Court infer or understand that there is some conflict between those statements. The fact of the matter is there is not, if the Court please, and if the Court will compare those two statements you will find that as to the items shown on the first statement, the comparable item shown on the second statement are identical. For instance, in the first statement labor was shown during the first period at 30 cents a [35] ton and in the second statement it was likewise shown at 30 cents a ton. Material was shown at 12 cents a ton in the first statement and 12 cents a ton in the second statement. Power was shown at 11 cents a ton in the first statement and 11 cents a ton in the second statement. Those are the only three items that were covered in the first statement, apparently the only three items as to which the plaintiff requested the figures, and they are identical in the second statement; so that there is no conflict between those statements nor is anything in connection with the rendition of those statements such that would justify the inference that in making the 18-cent increase the defendant was including only direct costs or was interpreting or construing the contract to mean that only direct costs are to be included in determining cost of production.

The same thing is true as to the second period. The first statement shows 32 cents for labor, the second the same; material 22 cents in the first statement, the same in the second; power, 14 cents in the first statement, 13 cents in the second. There is a penny difference there, which apparently re-

sults from a rounding off of fractions. I submit, if the Court please, that is a completely unjustified argument and an attempt to distort the facts when counsel argues that from the fact that this first statement was rendered the Court can construe that the defendant's own conduct has construed the contractual language to mean only direct costs. [36]

The same thing is true as to counsel's statement regarding the negotiations that preceded the execution of this contract. I think it is a significant fact, and Your Honor will recall that when the plaintiff was presenting its case, the only evidence that plaintiff offered that would shed any light upon the negotiations between the parties, and therefore the intent that they had in mind when they adopted the contractual language, was this one letter that was written by Mr. Barrows on June 5, 1936, which was seven months before the contract which is in litigation here was executed. That letter referred to a contract that is utterly different from the contract that was finally entered into. It contemplated a contract whereby the defendant was going to purchase oyster shell from the plaintiff and the defendant was going to sell to the plaintiff lime and gypsum. The contract that we are concerned with in this litigation is a contract providing solely and exclusively for the sale of gypsum from the defendant to the plaintiff.

It is a very significant fact that in these preliminary negotiations, and at a time seven months before the execution of the contract, Mr. Barrows,

at the request of Mr. Colton, sent him a letter in which he said, "This is purely preliminary. There are a lot of things we will have to straighten out, but you have asked for my general outline as to what I have in mind, and here it is." It provided for the purchase of oyster shells. That is not in the contract. It provided for the sale of lime [37] by the plaintiff to the defendant. That is not in the contract. And it provided for the sale of gypsum by the defendant to the plaintiff. That is the only thing that is in the final contract. But the thing counsel would try to skirt over is it also said that the defendant is to have the privilege of canceling the contract at any time upon 15 months' notice. That was seven months before the contract was signed. That was the only evidence that the plaintiff put in the record, and they had Mr. Colton, the contracting party, sitting in this court at all times while they were presenting their case, and they deliberately refrained from closing that gap of seven months between the time that this preliminary communication was written to the time the contract was executed. Why, if the Court please, didn't plaintiff undertake to close that seven months' gap when many things transpired between the contracting parties, except that they knew that the only rational and logical explanation of what did transpire, and why that language that Mr. Barrows proposed did not in fact get into the final contract would be adverse to their contentions. We called Mr. Barrows and we had him fill that gap and tell what transpired between the time of these purely

preliminary negotiations seven months before the contract was executed, and incidentally, Mr. Barrows was not a sick man on the witness stand. He did not profess to be, and we do not claim he was. He has a chronic condition that requires him to take care of himself. But there was nothing [38] wrong with him while he was on that witness stand, and we do not claim that there was, and his testimony is 100 per cent so far as he is concerned. We make no excuses for his physical condition. We did not at that time except we did not want him held over to the afternoon session because he was supposed to go home and lie down. And what did Mr. Barrows say and what could Mr. Colton say to deny it? Mr. Barrows said that they had a number of conferences after this letter was written, and then finally in September—and we are still four or five months before the contract was executed—Mr. Colton said, “We have proceeded far enough. Let’s get the thing down in black and white and send us a draft of what you have in mind.” So Mr. Barrows sent Mr. Colton a draft, and that draft again contemplated the purchase of oyster shell by the defendant from the plaintiff, and the sale of both lime and gypsum by the defendant to the plaintiff, and that contract likewise included a clause which gave the defendant, not the plaintiff, a cancellation privilege. Your Honor will recall that in the final contract the situation is exactly reversed. The plaintiff can cancel this contract at any time it wants to. The defendant is stuck with it for 25 years, whether it likes it or not. Mr. Bar-

rows said that that was the bone of contention between them, that Mr. Colton insisted that not only would he not agree to a cancellation privilege upon the part of the defendant, but he insisted that the plaintiff have the exclusive [39] cancellation privilege. So then Mr. Barrows said, and his testimony is entirely logical and consistent, that he started thinking: If he was going to enter into a 25-year contract where his firm is bound to the contract for that period of time and the other contracting party can cancel at any time, then he had better give a little more thought to the question of price, because if things got out of hand they would be stuck with the contract and they could suffer substantial loss.

So that is his testimony? Plaintiff says that we have misquoted it in our brief, and I would like to quote it to the Court exactly from the transcript, and we did not misquote it in our brief. He says this:

“The discussion come down to conditions referring to production, cost of production, items of production cost. During this discussion I said, ‘Well, that is not sufficient, just the items.’ I said, ‘I wouldn’t be limited to those items, there are other items that go up to make up cost of production,’ and we argued. I mentioned a number of items. He said, ‘We can’t put all these items in.’ I said, ‘If we can’t do that, then make it the cost of production and we will let the accountant decide what cost of production is.’ That was the point of the conversation.”

So what is the substance of that conversation? He had originally suggested labor, materials and fuel and a cancelation [40] clause. Colton objected. He not only objected, he said, "No, you get a cancelation clause but we get out." Then Barrows said, "We are not willing to submit to direct cost"—this is the gist of it—"there are too many things that enter into it."

Colton said, "We can't put everything in there." And the Court will keep in mind that these are not accountants negotiating with each other and they did not profess to be accountants. They would not know what cost accounting was, I am sure, in a detailed and technical respect. So the sum and substance of it was that they mutually decided, "Well, whereas you, Mr. Barrows, had originally suggested only direct cost when you had a cancelation privilege, and whereas I, Mr. Colton, have objected to that and insist that I have the only cancelation privilege, therefore you will not be confined to only direct cost but we will say 'cost of production.' " and that is whatever it is.

Now, I do not think there is any way of avoiding that interpretation of what transpired between the parties, and I would like counsel to tell me what I asked Mr. Colton on the witness stand and which he was unable to answer. Mr. Barrows had originally suggested that the contract state that his firm would be entitled to a price increase only to the extent of their increases in direct cost. That is exactly what the plaintiff is contending for in this case, and so obviously that language would have

been much more beneficial to the plaintiff [41] than the language that ultimately got into the contract. So how come that language was changed if it was not exactly as Mr. Colton said had occurred. Certainly it would have been more beneficial to the plaintiff to have that precise language in there. We would be out of court, and the mere fact that it is not in there raises the inference which I submit is unavoidable that it is not in there because, exactly as Mr. Colton says, originally they intended only direct cost, and then he said he would not go for that. So it was to include all costs and all costs, according to the testimony of all the experts, including the plaintiff's experts and their tenuous theories of by-product cost accounting that were completely unsupported by any authority other than their own abstract opinions, is that in determining the cost of a manufactured product, it includes overhead. Any business man knows that and any accountant knows it. Mr. Bennett says overhead has nothing to do with the production of gypsum. How could they produce gypsum if they did not have a plant superintendent? How could they produce gypsum if they did not have clerical help and accounting help and meet all those other general expenses that in any well-organized business be net, and where you are making a number of different products must be allocated between those different products on some rational basis? Their own accountants could not avoid that. They admitted that. But then they came up with this theory that that is generally true where you [42] are manu-

facturing a number of products in a single plant; the overhead expense is an essential item in cost of production, but it is not true if you attach the label "by-product" to the thing that you are making. That label changes the whole deal, and when you attach that label, therefore, you do not include overhead, which ordinarily is includable. You include only direct charges.

So here are three independent experts, all from big firms, counsel says. He says you can't question their qualifications. They are all from big firms, Haskins & Sells, and I forget what the others are. They all make mistakes. Haskins & Sells made plenty of mistakes in the McKesson & Robbins case. That does not prove their qualifications. None of them profess to be cost accountants. Here are men who are arrogant and pompous, knowing they are going to be called to testify as expert witnesses on the subject of by-product accounting—and I am assuming now that gypsum is a by-product, which I do not think it is, but it does not make a particle of difference whether it is or not—and counsel says in their reply brief that our whole theory is premised on the basis that gypsum is not a by-product. That is palpably false. Our whole theory is premised on the basis that it does not make a particle of difference for accounting purposes whether it is a by-product or a product, and the hypothetical questions I put to every expert witness that I put on the witness stand assumed that gypsum is a by-product. [43] So their testimony was based upon the assumption, which was an assumption most fa-

avorable to the plaintiff, that gypsum is a by-product. So these plaintiff's experts come in here and they know they are going to be called as experts. They were sitting here on a per diem day after day while Mr. Flick was haranguing here as an expert on every subject in the world. One of them was here for seven days that I know of and he heard my cross-examination of Mr. Flick. When he came up with his expert opinions and I said, "Can you furnish me with any authority, and text writer, any paper that has ever been written anywhere, anything other than your own opinion drawn out of thin air that will substantiate your viewpoint?"

Mr. Flick said, "I have read a lot of stuff but no, I can't tell you anything. That is just my opinion."

So here are these experts sitting here. They knew that I am going to ask them the same question, and so we can reasonably assume that they did a little digging in preparation for their testimony; and still, when I took every one of them on cross-examination, I said, "Can you tell me any authority that will support those views?", not one of them could come up with a single authority.

And then they called the fountainhead of all this accounting knowledge, Professor Jackson. And I argued his testimony was not admissible. Mr. Bennett argued, "Here have been all these experts brought here. Here is a man in the teaching [44] profession. He is it."

So he went on the witness stand under the pretense that he was going to come up with all the

authorities that all the other experts did not have. He had written books even. I asked him, "Did you ever write anything to support what you have said on the witness stand?"

"No.

"Well, have you got anything from anyone else that is in accord with the opinions that you have expressed on the witness stand?"

"No."

So how much weight can the Court attach to witnesses of that caliber? Counsel says our witnesses did not have any authorities either. Now, that is untrue, and the record will show that they had an abundance of independent authority for their views. As a matter of fact, Mr. Maxwell had written a book himself showing that this was nothing that he had concocted for the purpose of this trial. He had written a book himself several years ago in which he expressed the same views he expressed from the witness stand. The only text or authority that counsel has seen fit to refer to is the Accountant's Handbook, but he has distorted the testimony regarding that. He says, "This handbook shows that in the coke industry they do not include the overhead expense in accounting for the by-product." And then he says Mr. Maxwell said when he pointed that out, [45] "Well, I don't like the book." That is probably false and the record will show that it is. Maxwell did not say that at all. Maxwell said, "I do not approve of that, and neither does the book approve of it. The book shows the various methods of cost accounting that are employed, and there are several of them, and

they are progressively more undesirable. This is the third method." What Mr Maxwell said was that the writer of the book did not approve of that method. He was pointing it out, I guess, as a bad example. But the fact remains that both on authority, logically and reasonably, if the expert testimony is to be appraised, it must be concluded that the testimony of the defendant's experts to the effect that in accounting for a manufactured product such as this, where it is an independent plant, where it requires independent labor, that you must include in accounting for the cost of production of that article overhead expense, just as you do in the case of any other manufactured article. And this idea of trying to pin a label on it and saying that that changes the whole approach, it borders on the ridiculous. That little recitation in the contract that the seller is contemplating a plan for the manufacture of magnesium oxide and production of a by-product gypsum, which is in a preamble--will the Court believe that the parties when they entered that contract, entered into that contract, understood that that little recitation up there at the beginning of the contract and before the contractual provision of the [46] contract would have the significance that counsel purports to attach to it at this time, that those laymen understood that, according to plaintiff's experts, that there was this tenuous, complex distinction in accounting between what they call a by-product and a co-product and if these parties did not understand it and they did not have that in mind, the mere fact that it is re-

ferred to as a by-product in the contract is completely irrelevant.

As I say, if Your Honor please, I do not think it makes any difference, and according to the weight of the expert testimony it doesn't make any difference for accounting purposes whether gypsum is a by-product or a co-product. It is not waste. It is not scrap. It is a manufactured product. Maybe it is a minor product. Maybe magnesium oxide is a major product and this is a minor product. That does not change the accounting approach. But the peculiar thing is that if you accept the definitions of plaintiff's own witnesses as to what they conceive of as a by-product, which calls for this completely revolutionary method of accounting, if you accept their own definitions, you must conclude that gypsum is not a by-product. Mr. Flick says, and the other witnesses were to the same effect, and they admit that they had collaborated together and they had agreed on their definition—they had to admit that; they were practically verbatim—that a by-product is something that is purely incidental to the manufacture of [47] another product. It happens accidentally. You can't help but make it, and the quantity of the by-product produced is in direct relation to the quantity of the major product produced. That was their premise. If you knock out that premise, then their whole testimony goes out the window.

What was the uncontradicted evidence? The uncontradicted evidence is that the quantity of gypsum produced is not in direct relation to the quan-

tity of magnesium oxide. The evidence is uncontradicted that throughout the entire time that this contract has been in effect the Westvaco Chlorine Products Company has utilized all the bittern available from the Leslie Salt Company for the purpose of recovering therefrom the maximum quantity of gypsum available; whereas the bittern that leaves the gypsum plant, and which is available for the production of magnesium oxide, has not been utilized to the maximum, and there were periods when a portion of it is wasted. So it is a peculiar by-product where you produce more of the by-product from the mother material than you do the main product, or where you extract the maximum of the by-product from the mother material but less than the maximum of the main product. And Professor Jackson completely knocked out all of the plaintiff's expert testimony when I put a hypothetical question to him and I said, "Assume that you have a commercial plant where you are using a common mother material, and you extract from that the maximum amount of chemical substance A and then [48] you extract less than the maximum of chemical substance B therefrom; would you say under those circumstances that substance A is a by-product of substance B?"

He said, "No," and that is the fact, and it is undeniable that it is the fact. And the weirdest argument I ever heard is the argument the defendant makes in his reply brief, where they say, "Despite defendant's pretensions to the contrary, the fact is that the quantity of gypsum produced is directly

dependent upon the incidental to the production of magnesium oxide." That is an asseveration they are now going to proceed to support. They say that the amount of gypsum produced is dependent upon the magnesium oxide. Now, they are going to prove it. They go on to say:

"For example, in 1943 defendant for the first time began using dolomite in its magnesium process instead of calcium hydroxide, in order to produce greater quantities of magnesium oxide. This change resulted in a decrease of 23 per cent in the tonnage of gypsum produced in 1943 as compared with tonnage produced in 1942."

So, to prove that the amount of gypsum produced is dependent upon the amount of magnesium oxide produced, they argue that in 1943 they increased the production of magnesium oxide and decreased the production of gypsum. So they are proving just the contrary. And furthermore, that statement in itself involves a completely false premise, and that is that the use of [49] dolomite decreased the production of gypsum. Mr. Wallace and Mr. Melhase both testified—and there is no contradiction of it—that the use of dolomite increased the production of magnesium oxide but had no effect whatever upon the quantity of gypsum produced, and that at all times since this contract has been in effect, the defendant had not produced the maximum quantity of gypsum that could possibly be recovered from the bittern that was available from the Leslie Salt Company. That testimony appears at pages 1055, 1056 and 1057 of the tran-

script, and 821 of the transcript. The argument is completely fallacious, and it is based upon a completely fallacious premise.

I want to point this out: Not one of the plaintiff's expert witnesses denied that there are other methods that can be employed in by-product accounting. They each said to exclude overhead. That is what they were called here to testify to and they did. That was only in their opinion; they could not furnish an opinion of anyone else that would support them that that is the proper method; but they admitted that there are other methods, and the very book that counsel presented in court showed that there are seven different methods of by-product accounting. So the evidence of the expert witnesses shows at least there is no single accepted uniform method of by-product accounting. The testimony of the parties themselves as to the negotiations that preceded the execution of the contract, if you are going to take the testimony of both parties, showed that [50] their minds never met on what cost of production was intended to mean. Mr. Colton said, well, he thought it means only direct cost. Mr. Barrows said, "No, I wouldn't limit myself to direct cost. I meant it to mean all costs, according to good accounting."

So we submit, if the Court please, and most sincerely, that under the circumstances of this case—we do not say that in every case the cost of production is a term that is so indefinite that the contract is void for uncertainty, but we say that under the circumstances of this case the court must con-

clude that the minds of the parties never met on the various central provisions relating to the price of the commodity that was the subject of the contract.

If you take the testimony of all the experts, you have a divergence of opinion as between them, but even plaintiff's experts agree that other methods, other than the ones that they contend for, although they claim it is the only proper one, that other methods are employed and other reputable accountants might very well employ them. So certainly the Court can't say that those two laymen when they got together and signed this contract were conscious of all these complexities and complications raised by the experts. So apparently they did not know what the term meant that they were using, and from their own testimony they each had something different in mind; and we submit, therefore, that the contract is void for uncertainty. [51] In response to the request that Your Honor made at the beginning of the argument, a suggestion as to what the Court should do, we feel very strongly that the Court should issue a decree that this contract is void for uncertainty, and therefore that the contract is terminated. Now, it has been argued that the plaintiff, well, how can you declare a contract void for uncertainty after it has been in existence for ten years? There is nothing unique about that. There was no occasion for controversy under this contract until this action was instituted. Certainly not as far as this defendant was concerned, because ever since the con-

tract was entered into, the plaintiff has been paying us the full price that we claim to be entitled to under this contract.

Counsel has accused me in their reply brief of attempting to make a point there that is not justified. My point is not, although I may very well have pleaded it, estoppel; I have not argued an estoppel. I am not claiming that by making those payments they foreclosed themselves from ever questioning the matters that are involved in this case. Let us assume they made some payments under protest. It was only the last couple that they protested, but let us assume this. My point simply is that until this action was instituted we never had any occasion to come into this court and ask that this contract be declared void for uncertainty because we were getting 100 cents on the dollar of everything we claimed. We had no occasion to do it. [52] So they said, "How can you, after ten years' performance under the contract, ask to have it declared for uncertainty?" Why can't we? They for the first time have come into court and have refused to pay us what we claim we are entitled to, and now for the first time the uncertainty has activated a real controversy. And there is nothing unique about that. The books are full of cases where there has been partial performance under a contract and then the defense of uncertainty is urged and the Court determines the contract is uncertain and so declares it, and the party who receives goods or things of value under the contract is obligated to pay on a quantum meruit basis. I won't labor

the Court with that at this time, but we show in our brief how that phase of the case can be disposed of. In any event, we would be entitled to what they deposited in court because according to their own testimony, it is under the market value of the gypsum during the time that they have been making the payments.

So we submit, if the Court please, the contract should be declared void for uncertainty. If the Court decides otherwise, we submit that the evidence preponderate, both the expert testimony and the evidence relating to the negotiations between the parties, in favor of the interpretation that cost of production was intended to mean what it ordinarily means, and that is the cost of producing a product. Counsel argues, "If you quit making gypsum, your overhead expense would go on anyway. [53] Therefore it is not a proper item to include." This same argument could be applied to the plaintiff's own operations. Your Honor will recall that the plaintiff's witnesses testified that they have a plant at Gerlach. They make four articles down there. Everyone was agreed that in determining the cost of those articles you include the overhead, for whatever purpose, and still it is undeniable that if they discontinued the production of one of those items their overhead would go on just the same. That does not detract from the propriety of the charge. It is still good accounting, and when Jackson says in determining whether it is economic to produce a by-product you figure only the direct cost, that is an expediency. That is for a particular

purpose. If you are making ten articles you are going to decide whether you are going to make the eleventh. Certainly a man would take a pencil and figure out how much it will cost him to make the eleventh. But if he has a contract to sell the eleventh product, when he starts to make it, and the contract says he is entitled to a price which is related to his cost of production, he is going to include all of his cost, and this business about those undeniable principles being inapplicable because somebody else is affected is, in my opinion, simply ridiculous. That is all the more reason for applying sound accounting methods. Sure, if I am operating a factory and I am making a number of products and for my own purpose, to satisfy my own curiosity or for my own business [54] reasons, I can set up my books of account on any basis I want. It may be more economical not to bother with overhead and things of that sort. But where you have a contract that says that your price is related to your cost, then you must include everything. And counsel states that their expert says that that is a reason for excluding overhead. Well, that was presumptuous of them if they did say that. That is not a matter of expert testimony. But the fact of the matter is that I asked Mr. Pryor, who was one of their experts, whether his opinions were influenced in any respect by the consideration that somebody else was affected and whether accounting principles changed according to whether somebody else is affected or not, and he said, "Certainly not." Anybody would have to answer that question that way. Do you want the reference to that, counsel?

Mr. Bennett: Yes, I would.

Mr. Rosenberg: I guess I could find a contrary statement from every expert you put on the stand.

Mr. Bennett: No, I am talking about Pryor's testimony.

Mr. Rosenberg: 634, line 24, where I was asking about overhead.

He said, "What do you mean by overhead?" I said, "You have been using the term for a day. What do you mean by it?" So he told me what he meant by it and I said, "I will use it in that sense." [55]

So I said, "Using it in that sense, you will concede in respect to joint products, co-products or by-products, overhead expense is properly included in determining cost of productions?"

"A. Manufacturing overhead, yes.

"Q. And that is true whether the manufacturer has a contract to sell that product to somebody and the price is to be determined according to the cost of production or not, isn't that true?

"A. That is right.

"Q. And so the contract and the fact that a certain party might be affected has nothing to do with it, does it?

"A. Not as far as by-product accounting is concerned."

Mr. Bennett: What page are you reading from?

Mr. Rosenberg: 634 and 635. Also, I would like to comment briefly on counsel's statement regarding their offers to arbitrate. I have always understood, in the first place, that any negotiations to-

wards settlement are inadmissible, in litigation between the parties. I am sure that is the rule. That was jockeyed into the case obviously for the purpose that counsel is now attempting to use it. I submit it is highly improper. It borders on being unethical to do that. But it is in the record, so let us consider there were efforts to negotiate an arbitration. There weren't all the particulars testified to that counsel mentioned. There is no evidence in the record that somebody said, "You name one, we will name one, [56] and let them name a third," and all that business. There is evidence in the record that there were efforts toward arbitration. So what? What does that mean? If I have a 25-year contract to sell a substantial quantity of a manufactured product, and I know that when I negotiated that contract, I told them I would not limit myself to direct cost and the contractual language was changed, and then the other fellow comes along and says, "I don't want to pay you any overhead but I will arbitrate it with you,"—that does not place me under any obligation. There is no untoward inference to be drawn from the fact that I refuse to arbitrate anything as basic as that. That is the lifeblood of this contract perhaps, and why should I arbitrate something as basic as that? And furthermore, if I am going to arbitrate, I would rather have somebody like Your Honor sitting in on the arbitration rather than some accountant. We had a pretty good display here as to what occurs between accountants. I have had experience with a lot of professional witnesses, engineers and account-

ants and it is a pretty dangerous process to have two strangers select a judge for you. I know the judge I am coming before here and I do not like arbitrations, and furthermore, I won't voluntarily arbitrate anything that I consider basic and vital to me and where I figure the attack is completely unjustified. I would rather take my chances in court as we are doing here, Your Honor.

Counsel mentioned again on his argument that you must [57] attach a label. The label "by-product" has been attached to this gypsum by a recitation in the contract, and therefore you can't prove a fact to the contrary. And he says Dr. Seaton admitted it was a by-product. So he pulls out an article written in 1931 by Dr. Seaton. This plant was not even constructed until 1937 and I imagine there was a lot of things that happened in those six years. We were operating pilot plants and experiments. We were submitting samples to the Pacific Portland Cement Company to see if we had a merchantable product before we went to the expense of constructing a substantial plant there. I do not care what Dr. Seaton said in 1931 and I don't care what that little recitation in the contract is. I think the fact controls, if it is a material fact, but it is not even a material fact. They say the contract price of \$2.80 was premised on the direct cost of production at that time. There is testimony to that effect. But you can't beat your head against a brick wall. How could there be cost of production in a plant that was not constructed until a year after this contract was executed? That is just seiz-

ing on little words and making capital of them contrary to what is acknowledged to be the fact.

In several places in the brief, if the Court please, the statement is made that none of the cases that were mentioned relate to a by-product. So here again is that mystical distinction between gypsum and any other product that is made in a plant, by a plant, and with labor because that label is [58] attached. But the fact is there in a California Supreme Court decision that we have cited in our brief that relates to a by-product, and it comes about as close to their own expert's definition of a by-product that you could possibly come and that is the case of *Meyers v. The Texas Company*, where the issue in controversy was the cost of extracting gasoline from a natural gas well, and the Court held that it included items that come within the category of overhead expense, like taxes, insurance and overhead, and here is what the Court says:

“The lease did not obligate the defendant to extract gasoline from the natural gas but provided that if it did lessee should pay lessor one-sixth of the proceeds after deducting the cost of extraction. It is immediately to be observed, therefore, that the possible extraction of gasoline was only an incident to the main undertaking and separate and apart therefrom, presumably dependent upon whether under the circumstances of the production of natural gas, its quantity and quality and the cost of extraction, it could be made profitable for all parties.”

If that is not a by-product, even according to their own expert testimony, then I do not know

what is: "purely incidental." And still the California Supreme Court says under a contract which required the determination of the cost, you include the same type of expenses that we claim must be included in this case. [59]

Now, the inconsistency of the arguments that have been made are almost appalling, if Your Honor please. The plaintiff argues this is a by-product because you can either make it or you do not have to make it, as you see fit. In one breath they argue at another point—I think it is page 16 of their reply brief—well, all this stuff about the cancellation clause is just a bunch of foolishness because they have in effect a cancellation clause and they can stop producing gypsum any time they want. In one breath they say we can't help but make it, and in the next breath they say we have what is equivalent to a cancelation clause. That would be little consolation to us if it were true. That is not tantamount to a cancellation privilege. The fact that we discontinued making a product for which we constructed the plant, if we canceled the contract, we can go on making the product and sell it to anybody we want—I didn't interrupt you, Mr. Bennett, and you said so many things that I disagreed with.

Mr. Bennett: You misquoted me.

Mr. Rosenberg: I don't think I am. I am just going to touch briefly on a couple of more points, Your Honor. The question of sampling is not terribly important but there is nothing in the contract pertaining to sampling. What counsel is asking the Court to do now is not to interpret the

contract, but to inject something into the contract that they feel should be in here, and our practice has been recently to give them a [60] composite weekly sample of this gypsum, which is a bulk product, and which when it gets into their plant they put in bins and store up to 500 tons of it at a time; so it is fungible goods. Why should it be sampled or tested on a car basis rather than weekly composite? That gives a fair criterion of what they are getting. And the ironical part of it they say we should sample and test every carload that goes out, and so one of the items that they attack most strongly among our items of overhead expense is our laboratory expense where we do the testing of the gypsum for the purpose of this contract. So in one breath they say, "Sample every car for us," and in the next breath they say, "You should not include that expense in there. That is wrong." How could they consistently maintain positions like that? They would have the Court to believe in their brief that this research that appears on the figures we presented to them is new products research. It is not anything of the kind. In that Exhibit 18 new products research and general laboratory expenses are combined in one figure, and the evidence is uncontradicted that that laboratory expense includes the expense of testing, analyzing gypsum, working out improvement in the process and all these other things that are done in the normal operation of a chemical plant.

One other thing is this sulphuric acid matter. The plaintiff would have the Court understand that

this is a new charge that results from a change in accounting practice that [61] was done for the purpose of loading this contract. There have been a lot of inferences of that kind but no proof. The fact of the matter is it is not. It is a charge which results from a change in basic operating conditions in the plant. I asked two of their own witnesses the question:

“If you have a charge which appears for the first time by reason of a change in circumstances, that is a proper charge?”

And this sulphuric acid does result from a change of circumstances. We formerly manufactured bromine, and we discontinued bromine, and from the time we discontinued bromine we are only making two products, gypsum and magnesium oxide, and the evidence is uncontradicted that the sulphuric acid is necessary to the manufacture of gypsum and it is not necessary to the manufacture of magnesium oxide, and we quoted in our brief the testimony of our chemist who conducted this test, where they tried to make gypsum without sulphuric acid into bittern. They ran a test for four days and he said the crystals were of such composition that it clogged the filtering machine and made the drawing processes extremely difficult. And so I said in my brief the testimony was that the gypsum that was produced without the use of sulphuric acid was unsatisfactory, and counsel took me to issue on that and said there is no evidence to that effect. I submit if you produce a product that you can not process without gumming up your machinery, [62]

it is unsatisfactory, and that is what the evidence was. They state now their expert chemist said you have to use sulphuric acid to make magnesium oxide. The evidence is uncontradicted that during the time we were conducting this experiment for four days and not using any sulphuric acid we made magnesium oxide. We sold it. We got no complaints, and it was perfectly satisfactory. So the evidence is undeniable that the sulphuric acid, from the time the manufacturer of bromine was discontinued, was necessary to the production of gypsum and the production of gypsum only, that the charge occurred not from a change in accounting methods but from a change in basic conditions in the plant, according to their own expert witnesses, and therefore the charge is proper.

I would like to go into some of the other items, our Honor, but time will not permit. I just want to mention one other thing and that is these figures we presented to the plaintiff, and I think the Court will remember them pretty well. Those figures were presented as a courtesy by us because they did not want to go to the expense of preparing them. We prepared them in the form that they asked for them. They would imply we are attacking our own figures. We are not attacking our own figures. We will vouch for the integrity of those figures. But they are attempting to use those figures and to disregard circumstances under which they were prepared and the explanation which was affixed to them when they were furnished. [63] That is what we object to.

Just one other thing. The burden of proof we have argued fully, Your Honor. The cases are completely in accord with our contention.

The Court: You have five minutes more.

Mr. Rosenberg: Where a plaintiff comes in and files a suit for declaratory relief, he has the burden of proving the allegations of his complaint, and in this complaint the plaintiff comes into this court and alleges that our cost did not increase more than so many cents per ton in one period and so many cents per ton in another period, and therefore the burden is upon them to prove the allegations of their complaint, and there just can not be any question about that. Counsel would argue that they could come in there and file this suit and come into court and say, "Good morning, Judge," sit down and we would have to go ahead and prove the case. One of the criteria that the case is set forth for determining who has the burden of proof is "Against whom?" Should a judgment be rendered if no evidence were produced? And if they came into this courtroom and sat down at that table and were mute, certainly there would not be any judgment in their favor. They say in our answer they have alleged that our costs did not increase, and we have said that they did and therefore that is our affirmative allegation that we must prove. That is ridiculous. Those affirmative allegations are merely the denials of a negative allegation, [64] and the fact of there being a negative allegation does not place any burden on us. And I might say certainly their contention now is utterly inconsistent with their con-

duct during their trial. I sat for eight days waiting for them to put a witness on, and if they were not assuming the burden of proof I do not know what they were doing.

“When an issue of fact is tendered by the complaint and denied by the answer, the plaintiff must prove the complaint even though it is a complaint for declaratory judgment.”

Here is what a federal court said in an insurance case. An insurance company comes into federal court on an accident policy and asks for a declaratory judgment that the beneficiary is not entitled to recover because the insured died from natural causes rather than an accident—in other words, asked for a negative judgment on a negative allegation. If they had sat back and waited for the beneficiary to file suit, the beneficiary would have had the burden of proof that the insured died from accident. But the insurance company jumped the gun and filed the suit, came into court, and then they wanted, just as the plaintiff does in this case, to cast the burden on the defendant, and this is what the Court said. This is a federal case. “Asking a judgment that it is not liable, it, the plaintiff, must prove it is not liable. Non-liability is one of the rights referred to in the act. Certainly the declarant must plead in his petition, **declaration or complaint** the facts which [65] entitle him to the judgment he seeks. What he pleads he must prove.”

Here they pleaded our costs did not increase and they must prove it, and I submit that they did not, if the Court please.

I just repeat: The contract should be declared void for uncertainty. If the Court thinks otherwise, there can not be any question but what the weight of evidence is in favor of inclusion of overhead and indirect costs.

Mr. Bennett: Your Honor has a 2:00 o'clock trial date. It will take me some time, and there are many things that counsel has said that I would like to reply to, and I hope in not doing it, Your Honor will not think for a moment that I accede to the truth or the validity of his contentions.

There is just one thing I want to mention. He has tried to make it appear that Your Honor should disregard the contemporaneous construction of the contract, which I say is separately one of the three reasons why the plaintiff's construction of this contract must be upheld. He would lead the Court to believe that in 1941 when his first price raise was made that we were told all about the inclusion of overhead. Obviously this letter that we introduced in evidence, of October 2, 1941, must show the contrary.

The Court: Limiting it to that letter, but that is not all the testimony. [66]

Mr. Bennett: The testimony is we went down and had a visit with them.

The Court: Yes.

Mr. Bennett: But Mr. Colton said he was not told at that time or any other time that there was any inclusion of overhead or indirect costs, and the man who wrote this letter is within this district, within thirty miles of this court. He could have

been brought as a witness. He was the accountant down there who wrote this letter, and if Mr. Colton or Mr. Camden had been told or shown that there had been any inclusion of overhead or indirect costs in that first price raise, they would have brought him. This letter says, "We have analyzed gypsum production costs for the years ending so-and-so," "We are attaching a recapitulation of labor, material and power costs, which account for 15 cents of the 18 cents a ton increase." What could be clearer and plainer to a person receiving that letter that these people were basing that first price increase solely on direct costs? If there had been any intention or any evidence or any fact that Mr. Camden or Mr. Colton had been otherwise advised, they would have brought Mr. Hurlbert here and he would have given that sort of evidence.

Mr. Rosenberg: That is the first time since this contract has been in effect that this plaintiff has been so magnanimous that a matter of three cents makes any difference to them. They are taking fractional deductions from our bills [67] where the contract only entitles them to full percentages, and they are questioning every penny or fractional penny, and I think it is reasonable to assume from their contract, their conduct, that if they did not know what those three cents were, they would have found out about it.

The Court: The matter is submitted gentlemen.

CERTIFICATE OF REPORTER

I, J. J. Sweeney, Official Reporter, certify that the foregoing 68 pages is a true and correct transcript of the matter therein contained as reported

by me and thereafter reduced to typewriting, to the best of my ability.

/s/ J. J. SWEENEY.

[Endorsed]: Filed March 2, 1948.

[Endorsed]: No. 12054. United States Court of Appeals for the Ninth Circuit. Pacific Portland Cement Company, a corporation, Appellant, vs. Westvaco Chlorine Products Corporation, a corporation, Appellee. Transcript of the Record. Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed September 30, 1948.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 12054

PACIFIC PORTLAND CEMENT COMPANY, a
California, Corporation.

Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPO-
RATION, a Corporation.

Appellee.

APPLICATION FOR AN EXTENSION OF
TIME TO FILE RECORD ON APPEAL AND
DOCKET APPEAL

Pacific Portland Cement Company, plaintiff and

appellant in an action in the District Court of the United States for the Northern District of California, Southern Division, Civil No. 26934-R therein, filed in said court on May 25, 1948, its notice of appeal to the above-entitled court from a judgment entered April 26, 1948. On July 1, 1948, said District Court made its order extending the time for filing the record on appeal in the above-entitled court and for docketing the appeal therein to and including August 23, 1948.

Said appellant hereby makes application to the above-entitled court for an extension of time for said purposes to and including September 30, 1948. Said application is made upon the ground that the record in the action is very voluminous and the added time is necessary for counsel and for the clerk of the district court to prepare the record for filing in this court. Said application is based upon the stipulation of the parties and the affidavit filed herewith.

Submitted therewith is the form of order sought by the appellant.

Dated: San Francisco, California, August 13, 1948.

Respectfully submitted,

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,
/s/ FRANCIS R. KIRKHAM,
/s/ WALLACE L. KAAPCKE,
Attorneys for Appellant.

(Receipt of Copy.)

[Endorsed]: Filed August 14, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION FOR EXTENSION OF TIME
FOR FILING RECORD ON APPEAL AND
DOCKETING APPEAL

It is hereby stipulated by the parties hereto that the time for filing in the above-entitled court the record on appeal and for docketing the appeal in said court may be extended to and including September 30, 1948, subject to the entry of an appropriate order, to which consent is hereby given.

Dated: August 13, 1948.

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ WALLACE L. KAAPCKE,

Attorneys for Appellant.

/s/ BACIGALUPI, ELKUS &
SALINGER,

/s/ CLAUDE N. ROSENBERG,

/s/ TADINI BACIGALUPI,

Attorneys for Appellee.

[Endorsed]: Filed August 14, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

AFFIDAVIT IN SUPPORT OF APPLICATION FOR EXTENSION OF TIME TO FILE RECORD ON APPEAL AND TO DOCKET APPEAL

Wallace L. Kaapeke, being first duly sworn, deposes and says that:

He is an attorney admitted to practice in the above-entitled court and is one of the attorneys for the appellant in this cause. In said cause (the action bearing Civil No. 26934-R in the District Court of the United States for the Northern District of California, Southern Division) judgment was entered April 26, 1948, and appellant filed its notice of appeal to this court on May 25, 1948. On July 1, 1948, said District Court made its order extending the time for filing in this court the record on appeal and for docketing the appeal herein, to and including August 23, 1948.

The record in the case is very voluminous, the transcript of the proceedings at the trial comprising 1230 pages, and there being other voluminous documents contained in the record. The case is of a technical accounting and chemical nature, and due to the technical nature of the testimony, a great number of corrections in the transcript have been necessary. Counsel for both parties have now been able to agree upon the corrections to be made, but affiant is informed that a substantial period will be required for the reporter to make the corrections. Affiant is further informed that the clerk of the Dis-

trict Court of the United States for the Northern District of California, Southern Division, requires further time for preparation of the record on appeal and will welcome an extension of time to September 30, 1948. Counsel for the appellant also need that period of time within which to complete their study of the record, their determination of the portions thereof to be printed, and their preparation of the statement of points intended to be relied upon on appeal.

/s/ WALLACE L. KAAPCKE.

Subscribed and sworn to before me this 13th day of August, 1948.

[Seal] /s/ ALICE E. LOWRIE,
Notary Public in and for the City and County of
San Francisco, State of California.

[Endorsed]: Filed August 14, 1948. Paul P.
O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE RECORD
ON APPEAL AND TO DOCKET APPEAL

Upon the application of appellant, Pacific Portland Cement Company, and the stipulation and affidavit filed therewith, and good cause appearing therefor, it is hereby Ordered that the time for filing in this court the record in the above-entitled cause (the action bearing Civil No. 26934-R in the District Court of the United States for the Northern District of California, Southern Division), and the time for docketing the appeal herein, be and it is hereby extended to and including September 30, 1948.

Dated: August 13, 1948.

/s/ WILLIAM DENMAN,
Senior Circuit Judge.

[Endorsed]: Filed August 14, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT OF POINTS ON WHICH
APPELLANT INTENDS TO RELY

Appellant, Pacific Portland Cement Company, makes the following statement of the points on which it intends to rely upon the appeal herein:

1. The trial court erred in declaring that the terms "cost of production" and "cost of manufacture" as used in paragraph (6) of the contract between the parties dated January 29, 1937, are not

limited to actual or direct costs, and in declaring that said terms include overhead expense and indirect charges which cannot be directly charged to or against each of the various products produced by appellee at its Newark, California, plant, in that each of said declarations is contrary to said contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

2. The trial court erred in declaring that appellee's cost of production of gypsum as determined by appellee from time to time and the resultant increases in price established by appellee from time to time have been in accordance with the terms and provisions of said contract, in that said declaration is contrary to said contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

3. The court erred in declaring that appellee's cost of production of gypsum for the period July 1, 1939, to June 30, 1940, was \$1.66 per ton, or any amount in excess of \$.85 per ton, and in declaring that appellee's cost of production for the period July 1, 1940, to June 30, 1941, was \$1.84 per ton, or any amount in excess of \$.93 per ton, in that each of said declarations is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

4. The trial court erred in declaring that on September 4, 1946, appellee became entitled under the contract to an increase of \$.78 per ton (from \$2.98 to \$3.76) in the price of gypsum sold to appellant, by reason of an increase of \$.78 per ton in appel-

lee's cost of production of gypsum. Said declaration is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto to the extent of any increase in appellee's cost of production and resultant increase in the price in excess of \$.29 per ton. The difference of \$.49 per ton is made up of the following items charged by appellee to the cost of production of gypsum, in the allowance of each of which the court erred, for the reasons above set forth:

(a) An increase of \$.12 per ton due to appellee's charging expense for "new products research";

(b) An increase of \$.05 per ton due to appellee's charging expenses of its west coast operations of a general and administrative nature;

(c) An increase of \$.32 per ton due to appellee's charging other overhead expenses and indirect charges.

5. The trial court erred in declaring that on November 13, 1946, appellee became entitled under the contract to an increase of \$.60 per ton (from \$3.76 to \$4.36) in the price of gypsum sold to appellant, by reason of an increase of \$.60 per ton in appellee's cost of production of gypsum. Said declaration is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto, to the extent of any increase in appellee's cost of production and resultant increase in the price in excess of \$.25 per ton and to the extent of any increased price in excess of \$3.52 per ton. The difference of \$.35 per ton is made up of the following items charged by appellee to the cost

of production of gypsum, in the allowance of each of which the court erred, for the reasons above set forth:

(a) Increases of \$.03 per ton due to appellee's charging indirect shipping expense and the cost of use of an air compressor and due to appellee's failure to apply consistent accounting methods in the two cost periods compared with respect to indirect shipping expense and the cost of use of an air compressor;

(b) An increase of \$.23 per ton due to appellee's charging the cost of sulphuric acid and due to appellee's failure to apply consistent accounting methods in the two cost periods compared with respect to the cost of sulphuric acid;

(c) An increase of \$.06 per ton due to appellee's charging expenses of its west coast operations of a general and administrative nature;

(d) An increase of \$.03 per ton due to appellee's charging other overhead expenses and indirect charges.

6. The court erred in declaring that for the purpose of analyzing gypsum sold to appellant to determine its conformity or non-conformity to the specifications of the contract, a composite sample of the aggregate quantity of gypsum shipped to appellant in a 24-hour day affords a fair and proper criterion of the gypsum delivered, and in declaring that such method of sampling is in accordance

with the terms and provisions of the contract. Each of said declarations is contrary to the contract, is unsupported by the evidence, and is contrary to the law applicable thereto.

7. The court erred in declaring that under paragraph (5) of the contract plaintiff is entitled, in the event the gypsum content of gypsum sold to appellant falls below 95.51%, to deduct from the contract price of such gypsum the amount of \$.10 per ton only for each full percentage by which the gypsum content falls below 97.51%, and that plaintiff is not entitled to deduct fractions of \$.10 per ton on account of fractions of a full percentage in gypsum deficiency. Said declaration is contrary to the contract and to the law applicable thereto.

8. The trial court erred in holding that appellant had the burden of proof to establish that the price increases claimed by appellee were unjustified. Said holding is contrary to the law, for the reason that appellee has the affirmative of the issue whether its cost of production of gypsum had in fact increased as asserted by defendant, and consequently appellee had the burden of proof to establish that the price increases claimed by it were justified.

9. The trial court erred in declaring that plaintiff is not entitled to judgment against defendant for the sum of \$9,405.93 or any other sum.

10. The trial court erred in adjudging that the respective parties should pay their own costs.

Dated: San Francisco, California, the 11th day of October, 1948.

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ W. L. KAAPCKE,

Attorneys for Appellant.

[Endorsed]: Filed October 12, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF EXHIBITS IN ORIGINAL FORM

Pacific Portland Cement Company, Appellant, and Westvaco Chlorine Products Corporation, Appellee, hereby stipulate that Plaintiff's exhibit 16 and Defendant's exhibit I, included in item 24 of the Designation of Parts of Record Necessary for Consideration filed herein by Appellant, need not be printed as part of the record, but may be considered in their original form, and in such form shall constitute a part of the record on appeal. Plaintiff's exhibit 16 consists of a large chart, and Defendant's exhibit I consists of photographs, and neither of said exhibits can feasibly be reproduced by printing. This stipulation is made without prejudice to the right of Appellee to designate ad-

ditional parts of the record which Appellee thinks material.

Dated: San Francisco, California, the 8th day of October, 1948.

s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ WALLACE L. KAAPCKE,
Attorneys for Appellant.

s/ BACIGALUPI, ELKUS &
SALINGER,

/s/ CLAUDE N. ROSENBERG,

/s/ TADINI BACIGALUPI,
Attorneys for Appellee.

[Title of U. S. Court of Appeals and Cause.]

ORDER FOR CONSIDERATION OF
EXHIBITS IN ORIGINAL FORM

Upon the stipulation of Appellant and Appellee on file herein and good cause appearing therefor, it is hereby ordered that Plaintiff's exhibit 16 and Defendant's exhibit I need not be printed as part of the record, but may be considered in their original form, and in such form shall constitute a part of the record on appeal.

Dated: San Francisco, California, the 11th day of October, 1948.

/s/ WILLIAM DENMAN,
Chief Judge, U. S. Court of Appeals for the Ninth Circuit.

[Endorsed]: Filed October 12, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF PARTS OF RECORD
NECESSARY FOR CONSIDERATION

Pacific Portland Cement Company, appellant herein, designates the following parts of the record as necessary for the consideration of the points relied on:

1. Complaint, page 1 to page 11;
2. Motion and Notice of Motion for Order for Deposit in Court, together with Memorandum of Points and Authorities, and Order Shortening Time for Hearing of Said Motion, page 12 to page 17;
3. Order for Deposit in Court dated March 14, 1947, page 18;
4. Answer, page 19 to page 30;
5. Plaintiff's Reply to Counterclaims, page 31 to page 32;

(Here are omitted the following:

- a. Interrogations Propounded to Defendant, and Answers thereto, page 33 to page 60;
- b. Motion and Notice of Motion for Order Compelling Further Answers to Interrogations, page 61 to page 69;
- c. Motion and Notice of Motion for Production, Inspection and Copying of Documents, page 70 to page 76.)
6. Order for Refund out of Deposit in Court and for Reduction of Further Deposits, dated September 19, 1947, page 77 to page 78;
7. Amendment to Plaintiff's Reply to Counterclaims, page 79 to page 80;

(Here are omitted the following:

a. Motion and Notice of Motion for Production, Inspection and Copying of Document, page 81 to page 84.

b. Order for Production, Inspection and Copying of Documents, page 85 to page 86.

c. Notice to Produce Original Documents, page 87 to page 88.

8. Stipulation for Compromise and Dismissal of Defendant's First Counterclaim, page 89 to page 90;

9. Order for Entry of Judgment, dated March 30, 1948, page 91 to page 92;

(Here are omitted the following:

a. Motion and Notice of Motion for Order Terminating "Order for Deposit in Court" and for Payment to Defendant of Money on Deposit, page 93 to page 96. Said motion was disposed of by the stipulation and order designated herein as item 12;

b. The proposed findings of facts and drafts of judgment submitted by the parties, and objections thereto and proposed modifications and amendments thereof, page 97 to page 139.)

10. Findings of Fact and Conclusions of Law, page 145 to page 157;

11. Judgment, page 158 to page 161;

12. Stipulation and Order re Payments under Contract and re Stay of Judgment, page 140 to page 144;

13. Memorandum Opinion, dated May 3, 1948, page 162 to page 168;

14. Notice of Appeal with date of filing, page 169 to page 171;

15. Bond for Costs on Appeal, page 172 to page 173;

16. Designation of Contents of Record on Appeal (District Court), page 174 to page 177.

17. Stipulation for Transmittal of Original Exhibits, page 178 to page 179;

18. Order under Rule 73(g) Extending Time for Filing Record on Appeal and Docketing Action, page 180 to page 181;

19. Order Extending Time to File Record on Appeal and to Docket Appeal (by Circuit Court of Appeals), page 182;

20. Clerk's Certificate, page 183;

21. Statement of Points Intended to Be Relied on on Appeal;

22. Designation of Parts of Record Necessary for Consideration;

23. All of the Reporter's Transcript except the following portions thereof, consisting of arguments and statements of counsel, (the page and line references following are to page and line as enumerated in the Reporter's Transcript):

a. Page 2, line 1, to page 26, line 11;

b. Page 27, line 1, to page 43, line 16;

c. Page 114, line 25, to page 132, line 16.

24. The following exhibits marked for identification or received in evidence at the trial of the cause:

a. Plaintiff's exhibits 1 to 20, both inclusive;

b. Defendant's exhibits A to M, both inclusive;
(The depositions of Stanley H. Barrows,

James H. Colton, and L. O. Bannard, are omitted.)

25. Stipulation for Consideration of Exhibits in Original Form;

26. Order for Consideration of Exhibits in Original Form.

Dated: San Francisco, California, the 8th day of October, 1948.

/s/ PILLSBURY, MADISON &
SUTRO,

/s/ EUGENE D. BENNETT,

/s/ FRANCIS R. KIRKHAM,

/s/ WALLACE L. KAAPCKE,

Attorneys for Appellant.

[Endorsed]: Filed October 12, 1948. Paul P. O'Brien, Clerk.

